# Consolidated Statement of Income

(thousands except per share amounts)

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| **Net Sales** | **$2,387,110** | $1,343,134 | $1,085,890 |
| Costs of Goods Sold, Occupancy and Buying Costs | **1,668,267** | 938,813 | 758,274 |
| **Gross Income** | **718,843** | 404,321 | 327,616 |
| General, Administrative and Store Operating Expenses | **442,631** | 231,219 | 192,239 |
| **Operating Income** | **276,212** | 173,102 | 135,377 |
| Interest Expense | **(41,230)** | (16,662) | (10,248) |
| Other Income, net | **4,335** | 1,055 | 9,810 |
| **Income Before Income Taxes** | **239,317** | 157,495 | 134,939 |
| Provision for Income Taxes | **94,000** | 65,000 | 64,000 |
| **Net Income** | **$ 145,317** | $ 92,495 | $ 70,939 |
| **Net Income Per Share** | **$1.20** | $.77 | $.59 |

The accompanying Summary of Significant Accounting Policies and notes are an integral part of this statement.

# Consolidated Balance Sheet

(thousands)

| Assets | February 1, 1986 | February 2, 1985 |
|---|---|---|
| **Current Assets** | | |
| Cash and Equivalents | **$ 12,948** | $ 7,494 |
| Accounts Receivable | **62,077** | 45,912 |
| Inventories | **320,305** | 190,014 |
| Prepayments and Other | **20,994** | 13,056 |
| **Total Current Assets** | **416,324** | 256,476 |
| **Property and Equipment** | **648,314** | 267,528 |
| **Investment in and Advances to Finance Subsidiaries** | **74,795** | 23,672 |
| **Other Assets** | **72,077** | 19,476 |
| **Total Assets** | **$1,211,510** | $567,152 |

| Liabilities and Shareholders' Equity | February 1, 1986 | February 2, 1985 |
|---|---|---|
| **Current Liabilities** | | |
| Accounts Payable | **$ 184,368** | $103,010 |
| Accrued Expenses | **103,381** | 47,719 |
| Income Taxes Payable | **9,253** | 9,378 |
| Deferred Income Taxes | **56,416** | 29,109 |
| **Total Current Liabilities** | **353,418** | 189,216 |
| **Senior Long-Term Debt** | **213,744** | 60,139 |
| **Subordinated Convertible Debt** | **175,000** | — |
| **Deferred Income Taxes** | **44,506** | 42,394 |
| **Other Long-Term Liabilities** | **20,767** | — |
| **Shareholders' Equity** | | |
| Common Stock | **59,917** | 29,807 |
| Paid-in Capital | **24,695** | 22,466 |
| Retained Earnings | **319,463** | 223,130 |
| **Total Shareholders' Equity** | **404,075** | 275,403 |
| **Total Liabilities and Shareholders' Equity** | **$1,211,510** | $567,152 |

The accompanying Summary of Significant Accounting Policies and notes are an integral part of this statement.

# Consolidated Statement of Shareholders' Equity (thousands)

| | Common Stock | | | |
|---|---|---|---|---|
| | Shares Outstanding | Par Value | Paid-in Capital | Retained Earnings |
| **Balance, January 29, 1983** | **29,216** | **$14,608** | **$12,267** | **$ 95,703** |
| Net income | — | — | — | 70,939 |
| Cash dividends | — | — | — | (7,056) |
| Exercise of stock options and other | 588 | 294 | 5,821 | — |
| Two-for-one stock split | 29,376 | 14,688 | — | (14,688) |
| ***Balance, January 28, 1984*** | ***59,180*** | ***29,590*** | ***18,088*** | ***144,898*** |
| Net income | — | — | — | 92,495 |
| Cash dividends | — | — | — | (14,263) |
| Exercise of stock options and other | 434 | 217 | 4,378 | — |
| **Balance, February 2, 1985** | **59,614** | **29,807** | **22,466** | **223,130** |
| Net income | — | — | — | 145,317 |
| Cash dividends | — | — | — | (19,118) |
| Exercise of stock options and other | 488 | 244 | 2,229 | — |
| Two-for-one stock split | 59,732 | 29,866 | — | (29,866) |
| **Balance, February 1, 1986** | **119,834** | **$59,917** | **$24,695** | **$319,463** |

The accompanying Summary of Significant Accounting Policies and notes are an integral part of this statement.

# Consolidated Statement of Changes in Financial Position (thousands)

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| **Cash was provided from:** | | | |
| Operations | | | |
| Net income | **$145,317** | $ 92,495 | $ 70,939 |
| Add expenses not requiring working capital | | | |
| Depreciation and amortization | **80,128** | 34,526 | 28,427 |
| Deferred income taxes and other | **(3,030)** | 7,587 | 12,511 |
| Working capital from operations | **222,415** | 134,608 | 111,877 |
| Cash flow additions (requirements) resulting from | | | |
| Inventories | **(51,342)** | (67,157) | (20,698) |
| Payables | **62,567** | 36,240 | 2,147 |
| Income taxes | **11,082** | 16,326 | 8,779 |
| Other current assets and liabilities | **4,528** | 288 | 4,490 |
| **Cash provided from operations** | **249,250** | 120,305 | 106,595 |
| Other sources of cash | | | |
| Subordinated convertible debt | **175,000** | — | — |
| Other long-term debt | **346,590** | 38,290 | — |
| Disposal of assets | **8,323** | 2,716 | 25,252 |
| **Total cash provided** | **779,163** | 161,311 | 131,847 |
| **Cash was used for:** | | | |
| Net cash to acquire subsidiaries and retire debt | **331,462** | 14,142 | 24,493 |
| Reduction of long-term debt | **196,398** | — | 52,648 |
| Investment in property and equipment | **180,269** | 117,684 | 52,016 |
| Investment in and advances to finance subsidiaries | **47,456** | 8,000 | — |
| Cash dividends | **19,118** | 14,263 | 7,056 |
| Other, net | **(994)** | 1,010 | (159) |
| **Total cash used** | **773,709** | 155,099 | 136,054 |
| **Increase (decrease) in Cash and Equivalents** | **5,454** | 6,212 | (4,207) |
| Cash and Equivalents, beginning of year | **7,494** | 1,282 | 5,489 |
| **Cash and Equivalents, end of year** | **$ 12,948** | $ 7,494 | $ 1,282 |

The accompanying Summary of Significant Accounting Policies and notes are an integral part of this statement.

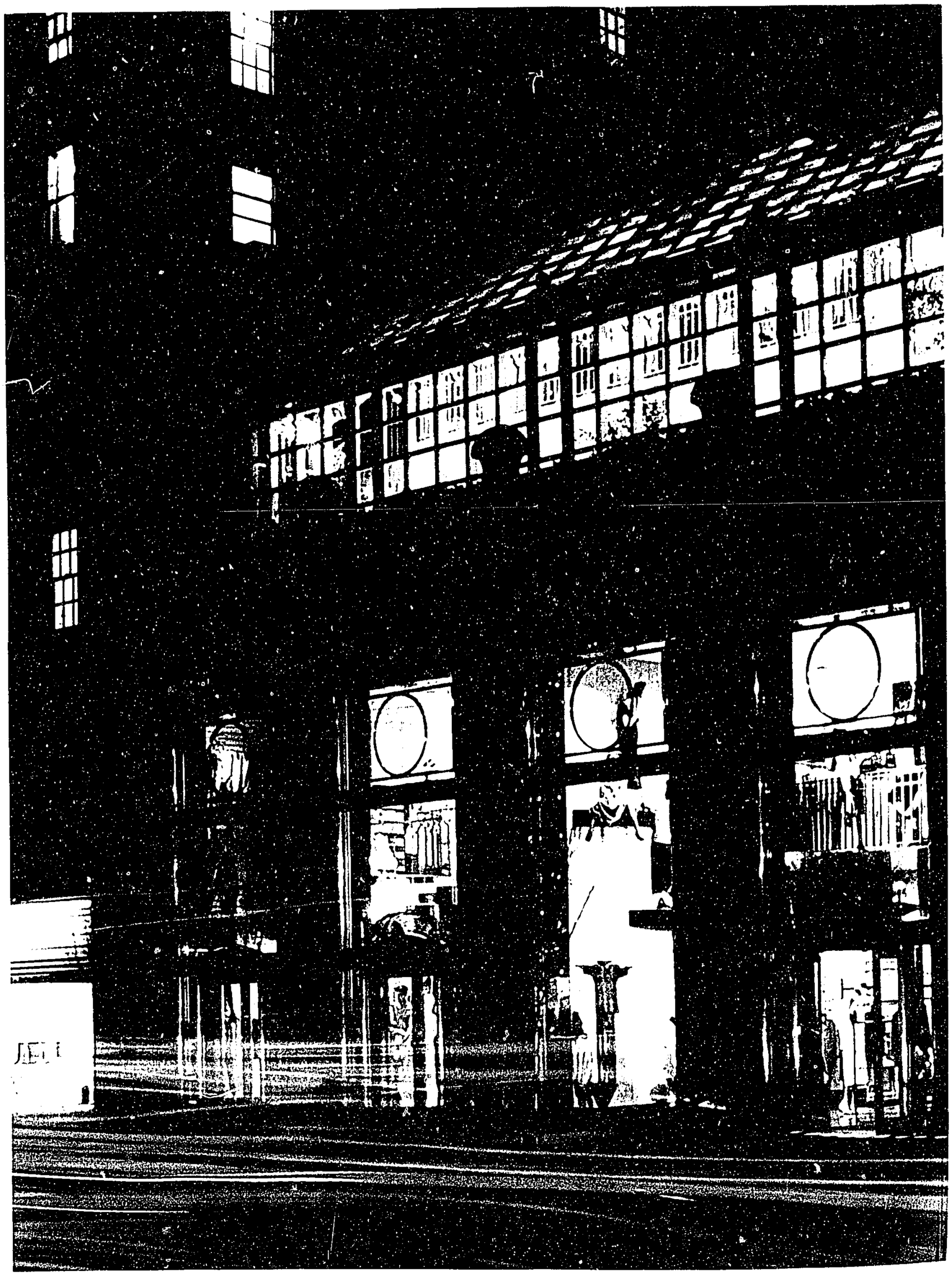
# THE LIMITED, INC.

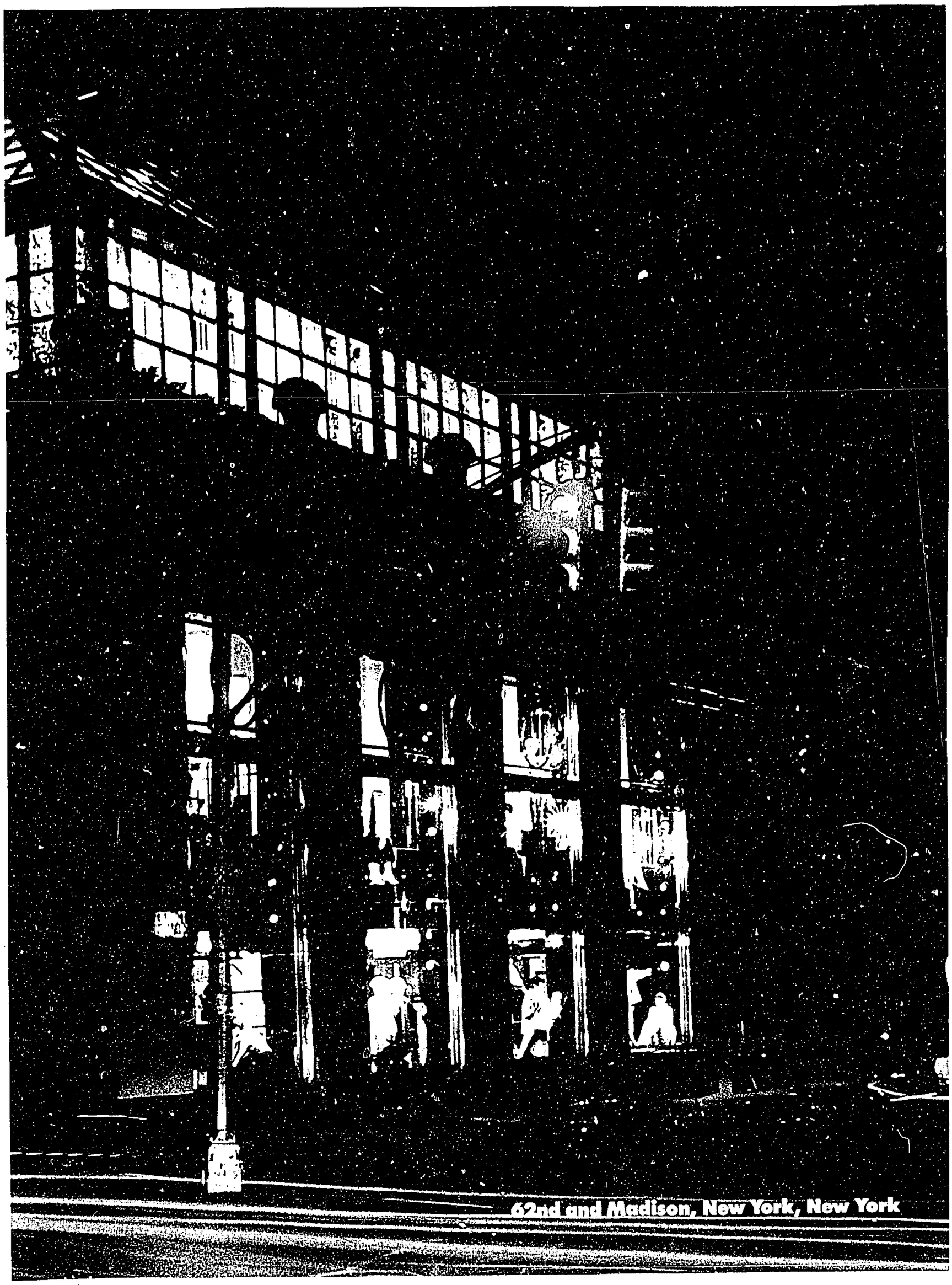
1985 ANNUAL REPORT



THE LIMITED, INC. 1985 ANNUAL REPORT

LIMITED





62nd and Madison, New York, New York

# "In 1985, The Li
# again recogniz
# specialty retai

**Forbes magazine, in its *1985 Annual Report on American Industry*, ranked The Limited, Inc. first among the specialty apparel retailers surveyed for stock appreciation, return on equity, earnings per share, and sales growth. I am pleased, but not surprised, that we performed so well. This performance is testimony to the capability and strength of our management teams and to the devotion and talent of every Limited, Inc. associate."**

**Leslie H. Wexner**
Chairman

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# Financial Highlights

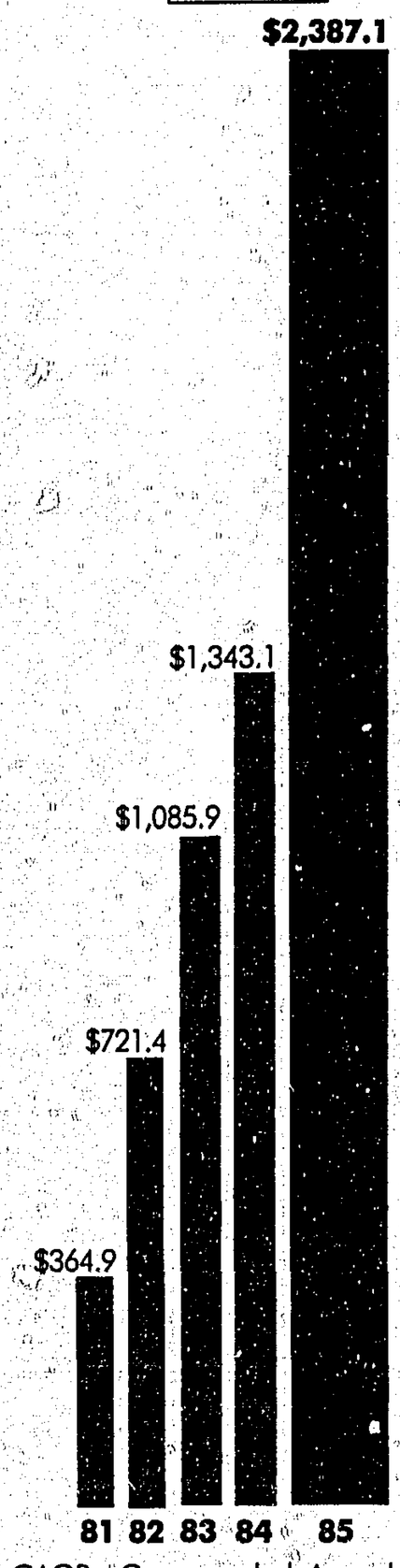
(thousands except per share amounts)

| Fiscal Year | 1985 | 1984 | % Change |
|---|---|---|---|
| **Operating Results** | | | |
| Net Sales | **$2,387,110** | $1,343,134 | 78% |
| Income before Income Taxes | **$ 239,317** | $ 157,495 | 52% |
| Net Income | **$ 145,317** | $ 92,495 | 57% |
| Net Income as a Percentage of Sales | **6.1%** | 6.9% | |
| Net Income Per Share | **$1.20** | $.77 | 56% |
| **Year End Position** | | | |
| Working Capital | **$ 62,906** | $ 67,260 | (6%) |
| Current Ratio | **1.2** | 1.4 | |
| Total Assets | **$1,211,510** | $ 567,152 | 114% |
| Subordinated Convertible Debt | **$ 175,000** | $ — | — |
| Shareholders' Equity | **$ 404,075** | $ 275,403 | 47% |
| Return on Average Shareholders' Equity | **43%** | 40% | |
| Book Value Per Share | **$3.37** | $2.31 | 46% |
| **Number of Stores Open at End of Year** | | | |
| Limited Stores | **597** | 562 | |
| Limited Express | **218** | 133 | |
| Lerner Stores | **750** | — | |
| Victoria's Secret | **93** | 46 | |
| Lane Bryant | **401** | 322 | |
| Sizes Unlimited | **293** | 349 | |
| Henri Bendel | **1** | — | |
| Total | **2,353** | 1,412 | |

# Financial Highlights

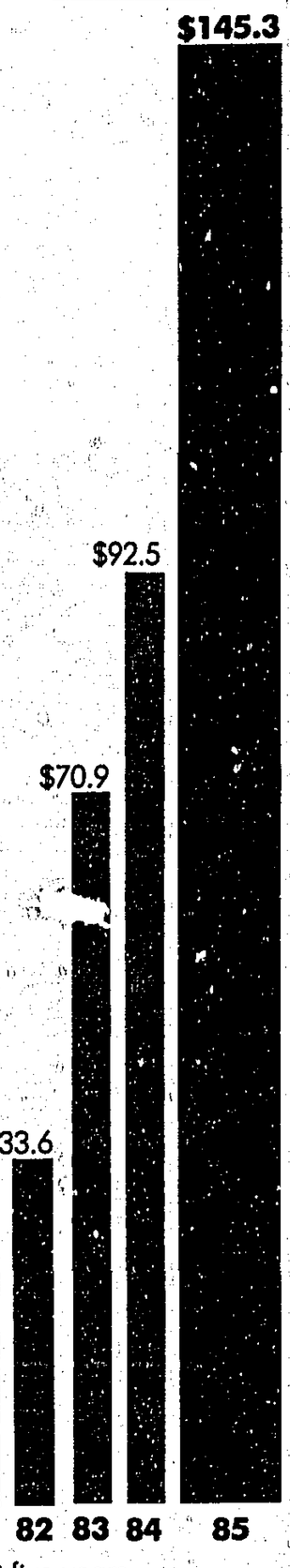
**NET SALES**
(In Millions)

CAGR 60%




**NET INCOME**
(In Millions)

CAGR 60%




**NET INCOME PER SHARE**

CAGR 57%




CAGR—Compounded Annual Growth Rate, last five years

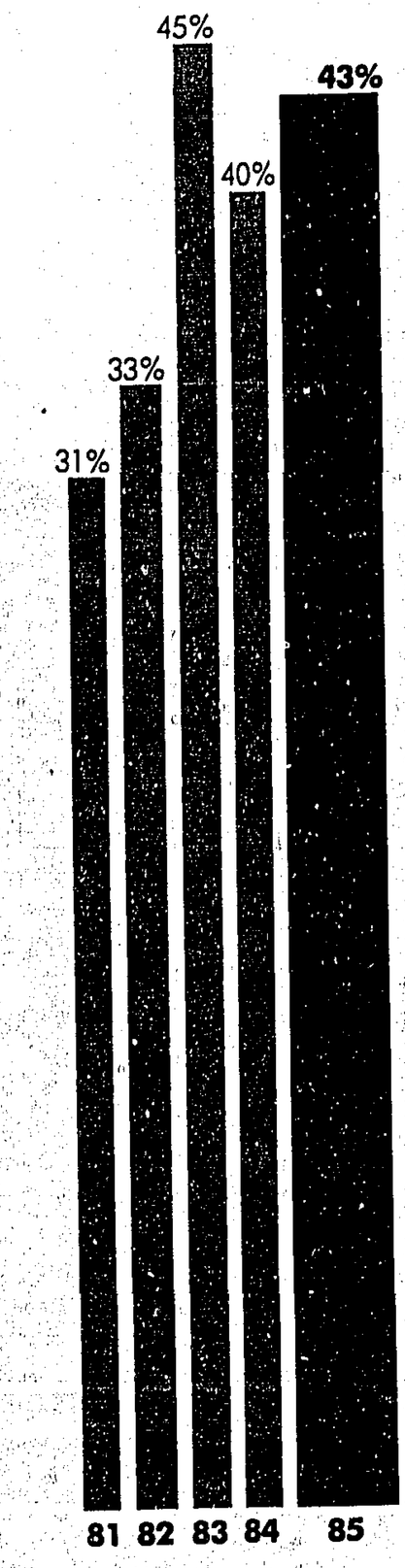
## DIVIDENDS PER SHARE

CAGR 70%




## RETURN ON AVERAGE SHAREHOLDERS' EQUITY

5 Year Average 38%




## SHAREHOLDERS' EQUITY

(In Millions)

CAGR 48%





# TO OUR SHAREHOLDERS:

I am proud to report that our twenty-second year has been the most profitable in the history of The Limited, Inc. Exceptional customer response to our fashion presentations and a continued focus on the execution of our marketing goals produced record results in each quarter of 1985. We are particularly pleased with the sales, profits, and productivity gains in Limited Stores, Limited Express, Lane Bryant, Victoria's Secret, and Mast Industries, our contract manufacturer.

## RECORD NET INCOME

Sales, earnings, and earnings per share reached record levels for the fiscal year ended February 1, 1986. Net sales increased 78% to $2.4 billion, while net income rose 57% to $145.3 million. Adjusting for the stock split of June 7, 1985, earnings per share were up 56% to $1.20 per share. These results were achieved at a time when we were acquiring and assimilating Lerner Stores, a company larger than any of our other divisions.

## 1985 MAJOR ACCOMPLISHMENTS

1985 was a significant year for The Limited, Inc.

- We achieved record earnings.
- We achieved record sales.
- We acquired Lerner Stores.
- We acquired Henri Bendel.
- We opened 267 stores, bringing the total to 2,353.
- We opened our first flagship store on Madison Avenue in New York City.
- We planned the opening of an additional 375 stores and the renovation of 275 stores for 1986.
- We launched "Moods by Krizia", a private brand created for The Limited by premier Italian fashion designer, Mariuccia Mandelli.
- We completed our new state of the art, one and one half million square foot Distribution Center in Columbus, Ohio. This facility gives us the capacity to support up to 5,000 stores.
- We doubled our mail order distribution capacity in Indianapolis, Indiana.
- We increased the number of Limited, Inc. associates from 17,700 to 25,300.
- We issued $125 million of Convertible Subordinated Debentures in the United States, and $50 million of Convertible Subordinated Bonds in Europe.

## ACQUISITIONS

On April 2, 1985, we acquired the 798-store Lerner chain for $297 million in cash. Lerner is the largest women's specialty apparel chain operating under one name in the United States. Although Lerner's volume on a comparable store basis had been stagnant for about four years, we believe the franchise provides us with significant growth opportunities. During the past year we implemented the following changes:

- We centralized the receipt and distribution of all Lerner merchandise through our Columbus Distribution Center.
- We instituted "Limited" systems in 90 days, one year ahead of schedule.
- We created a new buying team of experienced merchants who are focused on the needs of Lerner customers.
- We refined and refocused Lerner merchandising.
- We launched recognition and incentive programs designed to build the partnership between Lerner and its associates.
- We established a vendor's information program aimed at communicating to our suppliers our philosophy of customer focus.

Lerner has benefited from the expert leadership of former Limited Stores President, Bob Grayson, who has been successful in changing the direction of Lerner.

As a result of decisive action and strong leadership, Lerner Stores had a profitable fourth quarter, with inventories and markdowns on plan. Lerner has made significant progress and is positioned for a profitable 1986.

On October 21, 1985, we purchased Henri Bendel, New York's most prestigious specialty store. Established in 1890, this New York landmark caters to the upscale, fashion-forward customer. We believe there is a significant opportunity to expand Bendel stores to every major market in the United States.

**A FIVE YEAR PERSPECTIVE**

In 1985, The Limited was again recognized as a premier specialty retailer. Forbes magazine, in its *1985 Annual Report on American Industry,* ranked The Limited, Inc. first among the specialty apparel retailers surveyed for stock appreciation, return on equity, earnings per share, and sales growth. I am pleased, but not surprised, that we performed so well. This performance is testimony to the capability and strength of our management teams and to the devotion and talent of every Limited, Inc. associate.

At The Limited, we are determined to attract the best people and to provide the opportunity for challenging and rewarding careers. For every position, whether part-time associate or divisional president, we look for people who demand excellence. Excellence means the *best* merchandise, from the *best* vendors, displayed in the *best* stores or catalogs, backed by the *best* customer service from the *best* sales associates at stores headed by the *best* leaders—all combine to achieve our ultimate goal: to provide our customers with the *best* shopping experience anywhere.

This goal of consistent excellence is reflected in the leadership style of our ten chief executives, each of whom runs his or her business with an entrepreneurial flair that has the customer as its ultimate focus. Regardless of the individual differences among the companies, they all share one simple but vital belief: nothing happens until the customer buys something. This company-wide focus on the customer is spearheaded by our chief executives, division leaders who set the highest standards, standards that are responsible for The Limited's continued dramatic growth.

I would like to express my sincere appreciation to these hardworking chief executives and to all Limited associates for their commitment to making The Limited, Inc. a successful and prosperous business. The tough-mindedness of our executives is tempered with flexibility; their demanding standards balanced with human understanding. They have managed to keep their eyes on the bottom line, without forgetting that it is the effort of thousands of individuals who made the profits possible.

This "people first" philosophy has produced remarkable results. These results, however, would not have been possible without the support and confidence of another important group of people, our shareholders. To you, also, I extend my sincere gratitude.

In 1985 we learned that we have the capability, without acquiring other businesses, to become a $5 billion business in five years. We learned that our knowledge of merchandise, marketing, financial systems, real estate, store design, and distribution can be significantly leveraged. We confirmed that we have the capacity to set qualitative as well as quantitative standards for our industry. We confirmed our reputation for integrity with our customers, associates, suppliers, and shareholders. And, perhaps most importantly, we reaffirmed that we can accomplish these goals without sacrificing our bold spirit.

Leslie Herexner

**Leslie H. Wexner**

Chairman
April 7, 1986

# LIMITED

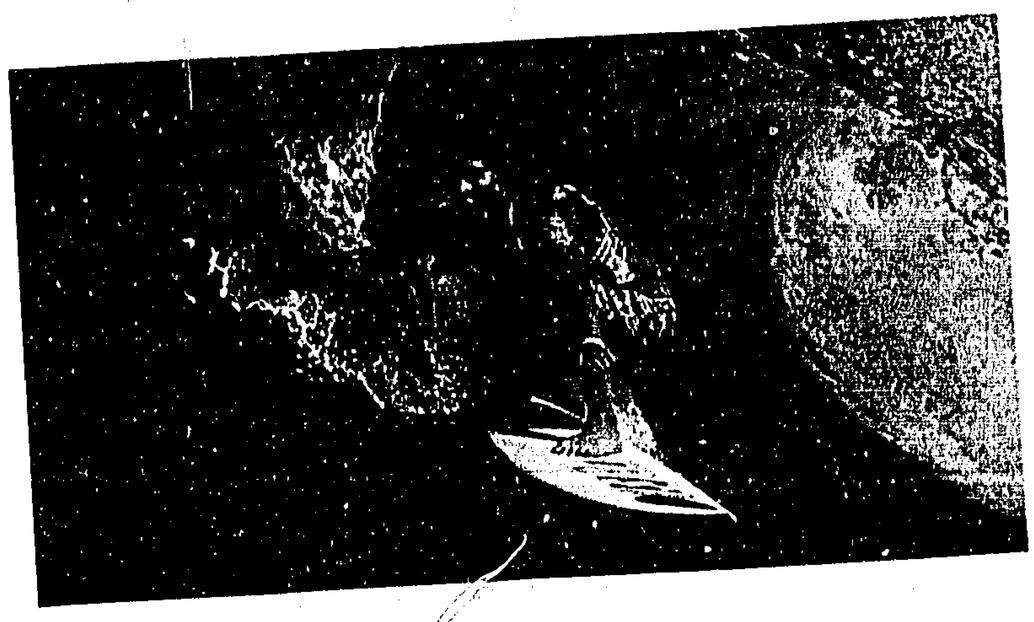
Our medium-priced sportswear, ready-to-wear, and accessories continue to suit the tastes and lifestyles of contemporary women, as they have for 22 years. But don't think success had made us complacent.

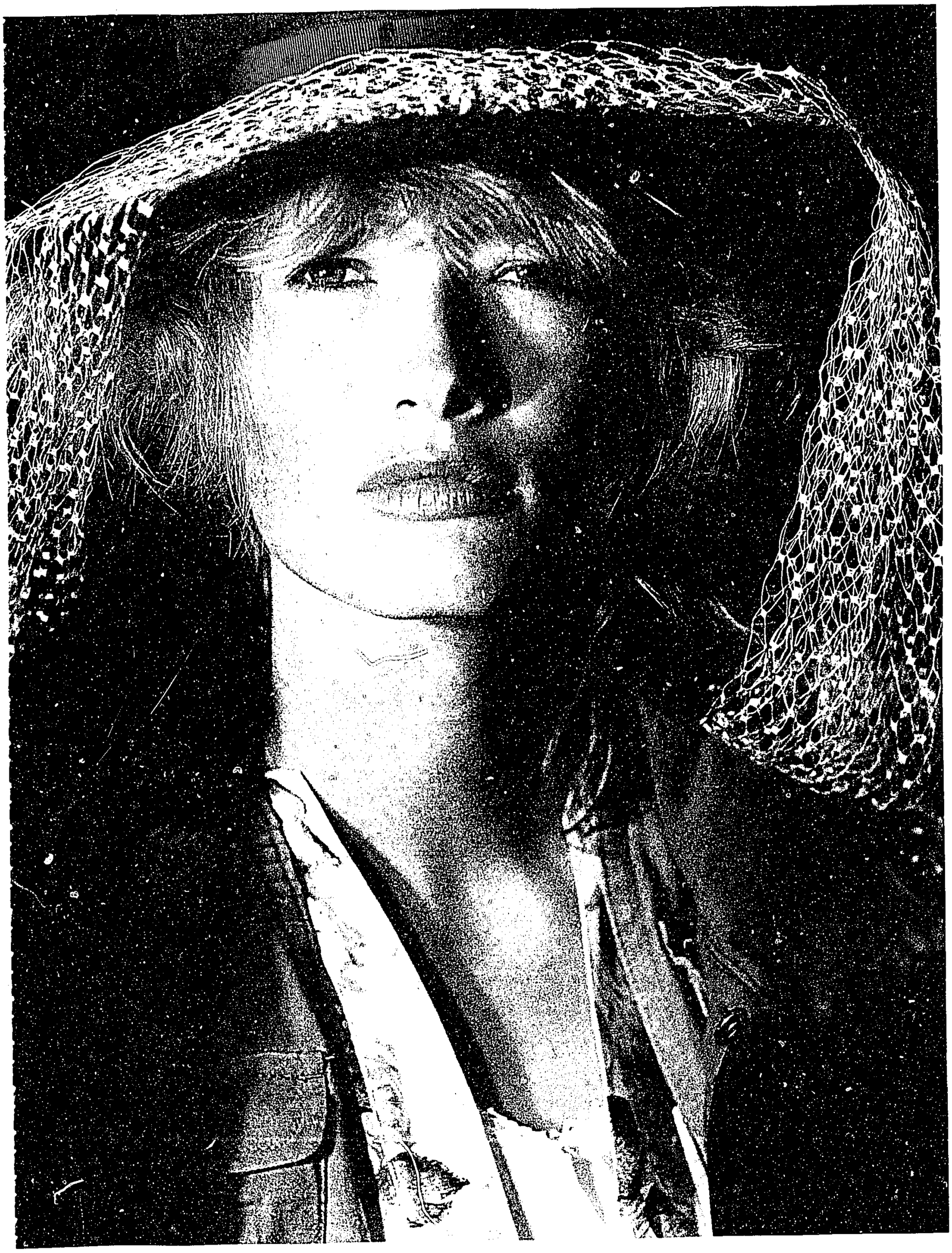
We're always on the lookout for fashion-forward designs—designs like Forenza, introduced two years ago, and now the fastest growing name in sportswear; or Outback Red, introduced in January and gaining national acceptance and recognition. We want our clothes to be fun, comfortable, easy to wear—and easy to buy. We have 597 Limited Stores, each with about 4,000 square feet of selling space, in downtown locations and in regional shopping centers in 125 major markets.



**"On every wall, even though you can't see it, is written, 'We will be the best.'"**

**Verna Gibson**
President, Limited Stores



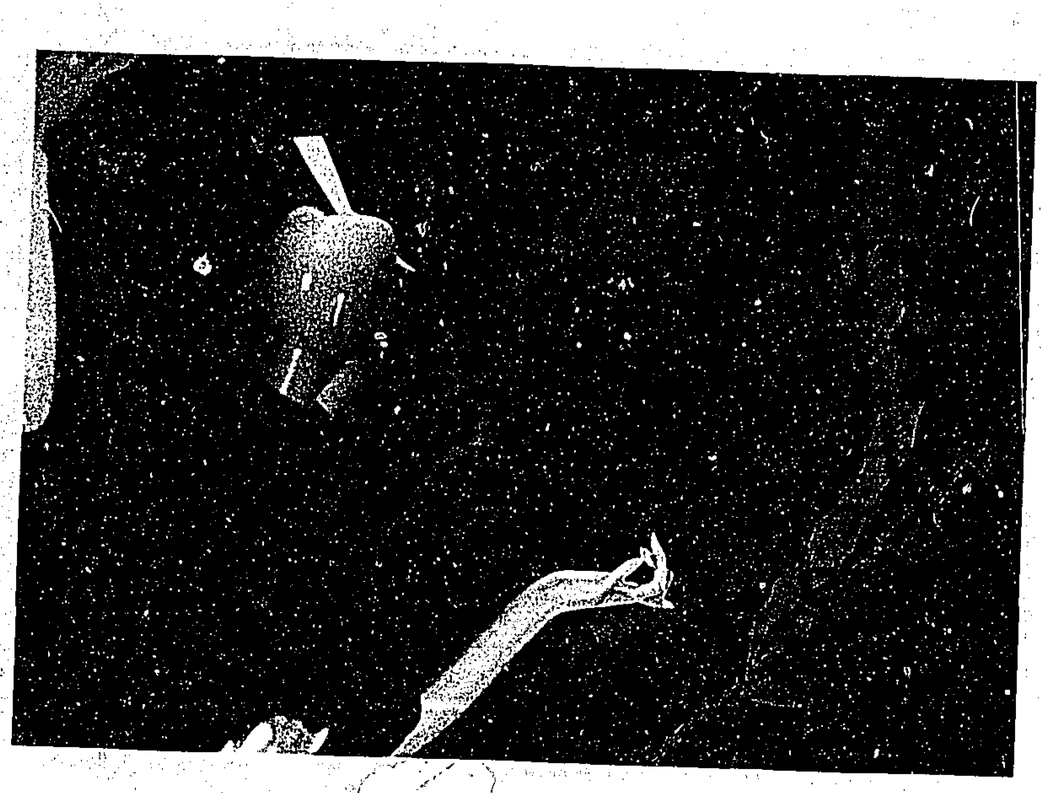


# LIMITED EXPRESS

Our spirited presentation of popular-priced sportswear and accessories makes shopping at Limited Express an exciting experience. At Limited Express we offer the latest, most creative American and international sportswear and accessories designed to appeal to fashion-forward women 15 to 25 years of age. Our focus on innovative fashion design is clearly apparent in our bold merchandise, store design, marketing, and sales presentations.

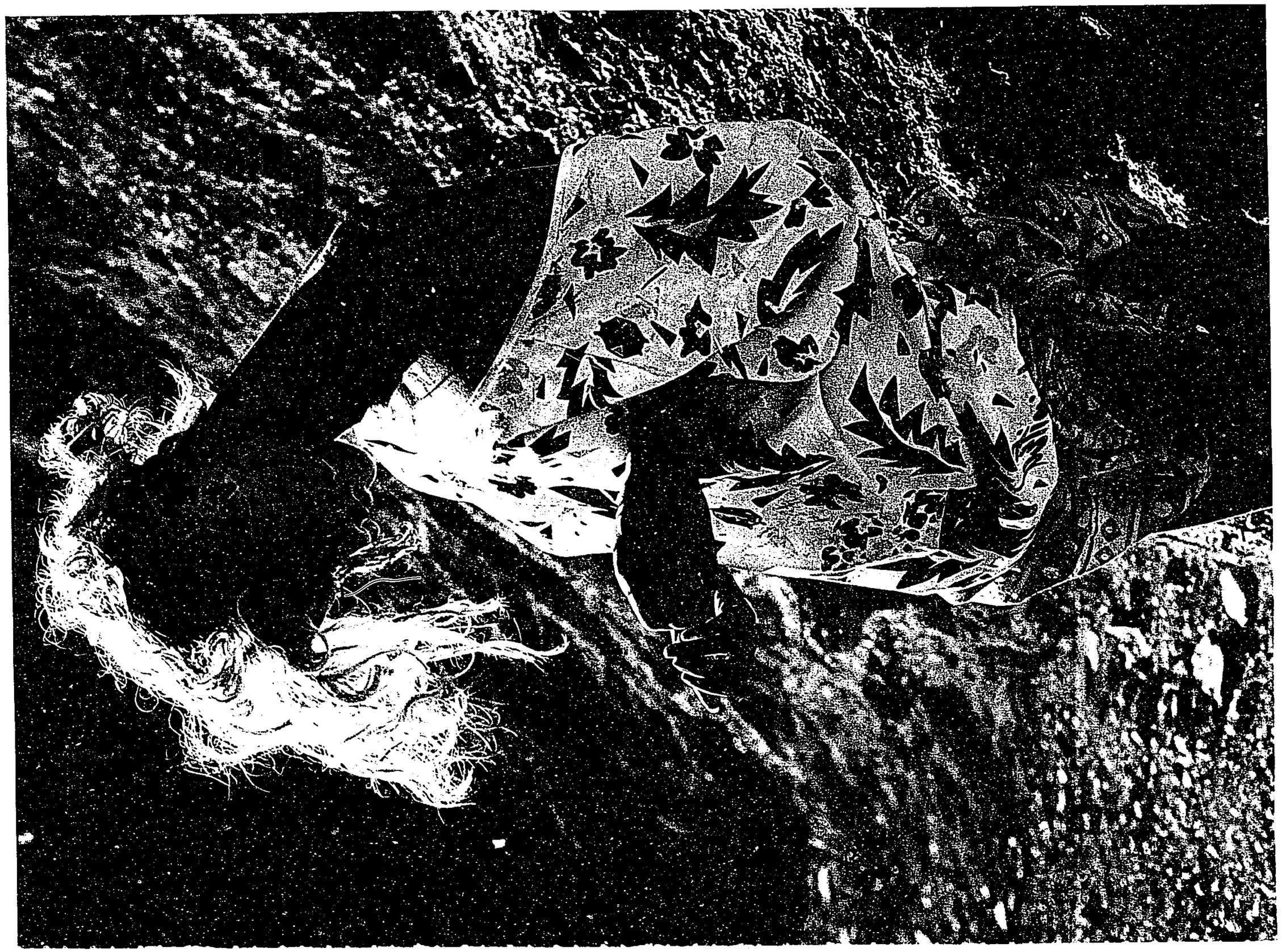
Currently there are 218 Limited Express stores located in major markets throughout the United States. While most Limited Express stores contain approximately 2,400 square feet of selling space, our new South Street Seaport store in Manhattan contains 9,000 square feet and represents the first of two Limited Express stores opened in 1985 in the nation's fashion capital.





**"Before Express, there really wasn't anyplace our customer could shop. The market existed. But not the store—Express filled a major void. The customer said, 'Finally!'."**

**Michael Weiss**
President, Limited Express

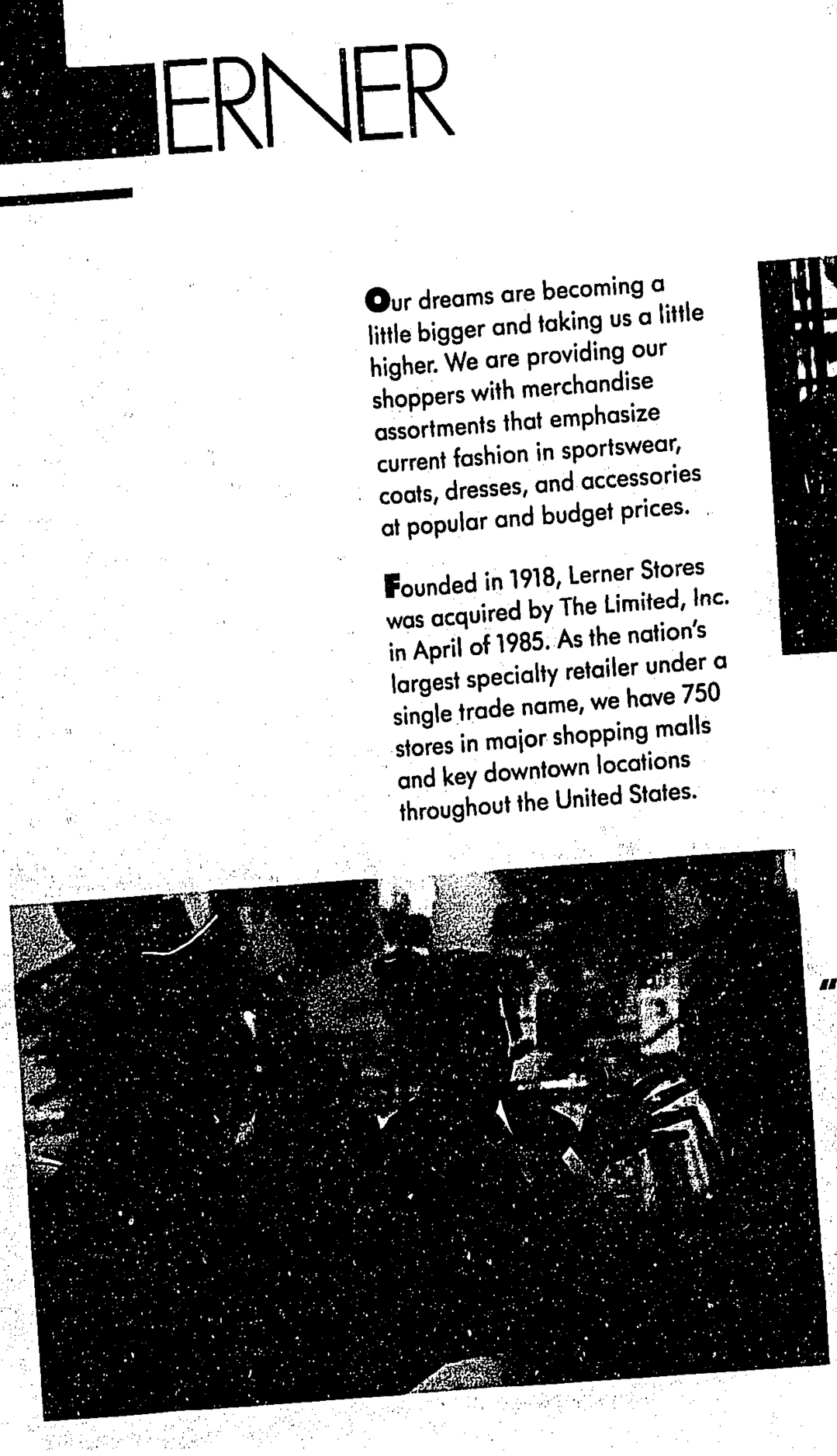


# LERNER

Our dreams are becoming a little bigger and taking us a little higher. We are providing our shoppers with merchandise assortments that emphasize current fashion in sportswear, coats, dresses, and accessories at popular and budget prices.

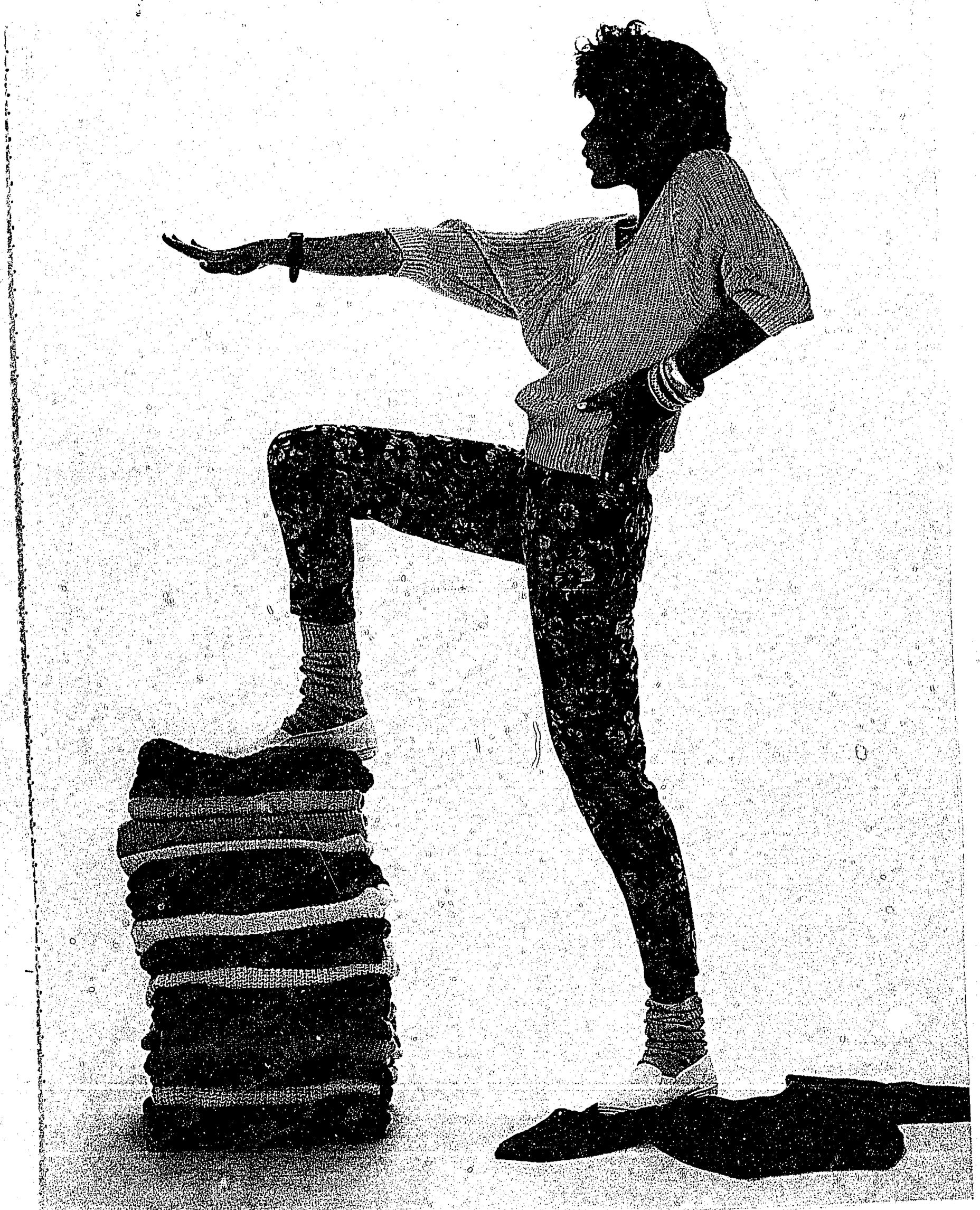
Founded in 1918, Lerner Stores was acquired by The Limited, Inc. in April of 1985. As the nation's largest specialty retailer under a single trade name, we have 750 stores in major shopping malls and key downtown locations throughout the United States.





**"When I look at Lerner today, I see a company ready to fly. Our people are energized. I believe we will make major contributions to the business this year. More importantly, Lerner people believe it!".**

**Robert Grayson**
President, Lerner Stores



# VICTORIA'S SECRET

**"I can look any of our store managers in the eye and say, 'If you have the determination and drive, you can become president.' I know. I did."**

**Howard Gross**
*President, Victoria's Secret*



Our greatest challenge is to build Victoria's Secret into the largest intimate apparel chain in the world. The number of our stores, offering American and European lingerie, more than doubled last year. Our colorful catalog, published thirteen times annually, assists our stores in offering quality intimate apparel to women everywhere.

A romantic ambiance permeates our 93 stores, each containing approximately 1,500 square feet of selling space. Victoria's Secret stores are located in regional shopping centers.








# LANE BRYANT



**"We opened 83 stores in 1985—that's a small chain in itself—while surpassing the double digit store-for-store increase challenge we set for ourselves. We are doing things we didn't know we could do."**

**Ira Quint**
President, Lane Bryant

Our success at Lane Bryant is based on our "customer first, last, and always" philosophy. We offer exciting fashion-forward, popular-priced sportswear, ready-to-wear, intimate apparel and accessories to women sizes 14 and up.



A part of The Limited family since 1982, our 401 stores are conveniently located in downtown and suburban sites in most major U.S. markets. Our customer focus has made Lane Bryant the nation's leading retailer of women's special-size apparel.



# SIZES UNLIMITED

**"We took a basic idea and made it into a major business. We brought management, professional buying, and tight cost control to 293 stores. We have momentum and enormous growth opportunities."**

**Raphael Benaroya**
President, Sizes Unlimited






At our 293 Sizes Unlimited and Smart Size Stores, we offer first quality, nationally known brand name and private label merchandise priced below similar goods in most department and specialty stores.

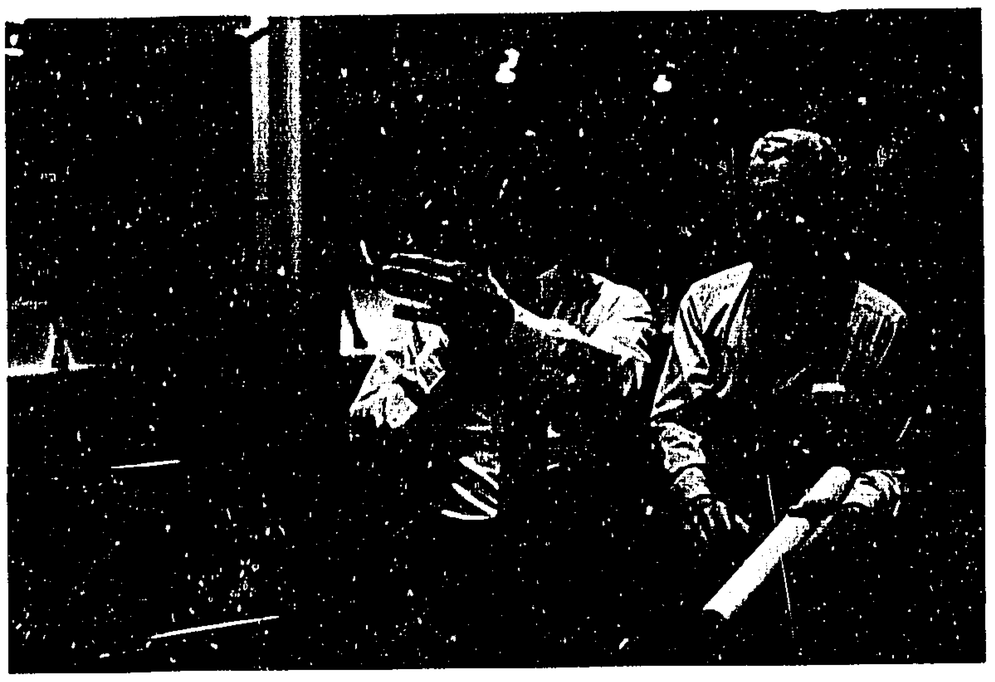
Our merchandise assortment includes sportswear, coats, suits, dresses, intimate apparel, and accessories. A typical store contains 3,500 square feet of selling space and is located in a smaller shopping center.



# BRYLANE

**"To be successful in the catalog business, you need quality products, first class presentation, and service, service, service. When you're going directly into someone's home, they better trust you. Here, they can. We back everything. Period."**

**Peter Canzone**
President, Brylane

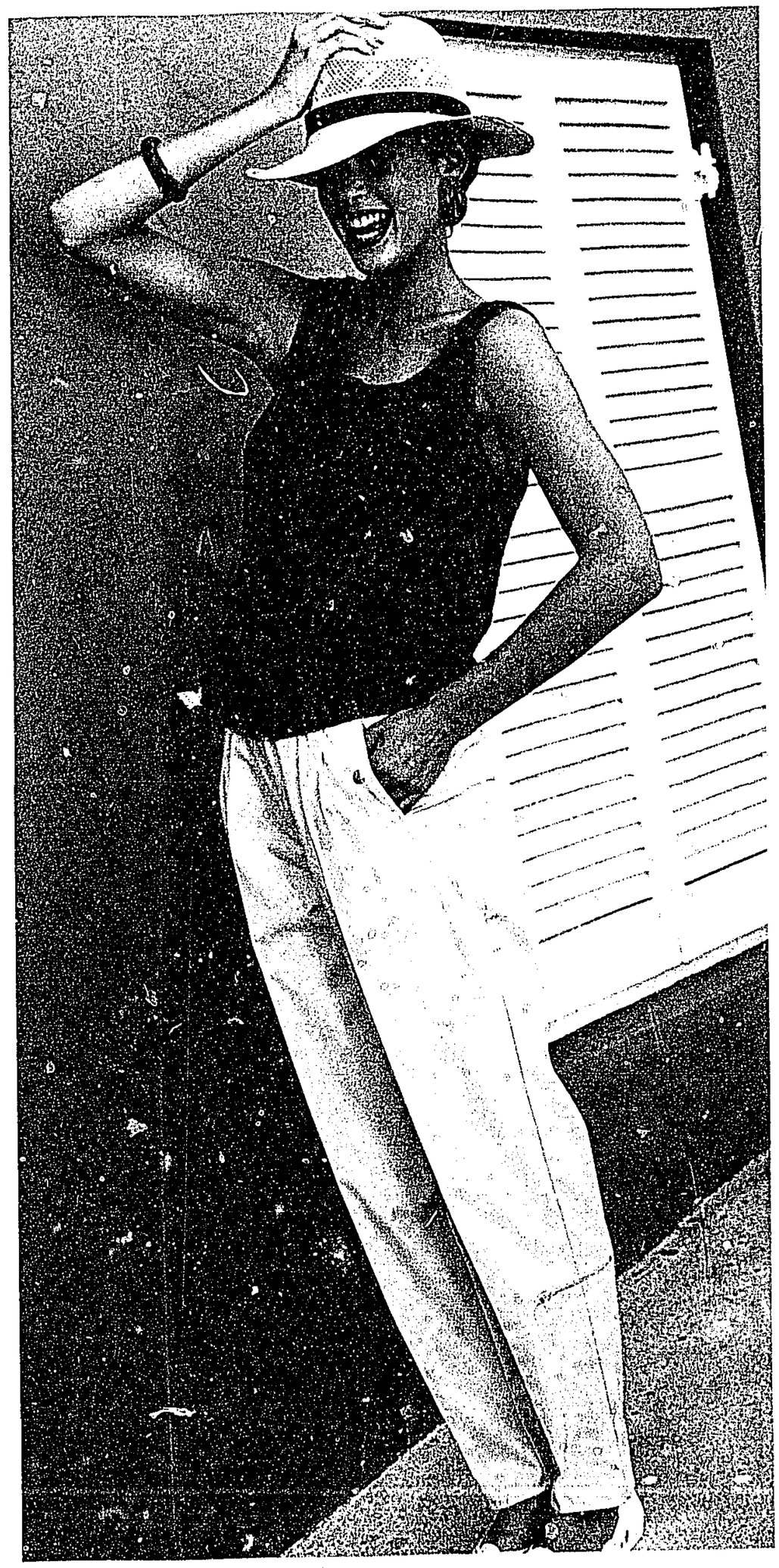


We are now the nation's largest catalog retailer of women's special-size apparel and shoes—and the third largest catalog retailer of all sizes of women's apparel and shoes. Our quality merchandise is backed with quality service from our Indianapolis Fulfillment Center, recognized as the most sophisticated shipping and receiving operation in the mail order industry.




Our division is composed of six catalogs: *Lane Bryant, Roaman's, Lerner Woman, Sue Brett, Lerner Sport and Tall Collection.*







# HENRI BENDEL





**"The past year is perhaps the most significant in Bendel history. A great store's future has been secured . . . and our potential for growth is dramatically increased."**

**Geraldine Stutz**
President, Henri Bendel

Henri Bendel customers are a special breed—upscale, sophisticated individualists with ahead-of-the-game taste in clothes and accessories. Backed by a tradition of excellence, our international looks appeal to women who want superlative style and quality.

As part of The Limited, Inc., we are planning to make Bendel's, a long time landmark in New York City, into a national presence—with stores in the top 40 markets. At Bendel's we are looking forward to making our special ambiance available to customers who want a distinctive, international shopping experience.



# MAST INDUSTRIES

The consistent, timely delivery of millions of units of quality merchandise is a challenge—and it's one we've filled proudly for The Limited, Inc. since 1971. At Mast Industries we work with more than 200 production facilities in 30 countries to supply The Limited Divisions with competitively priced apparel for fashion-conscious women.

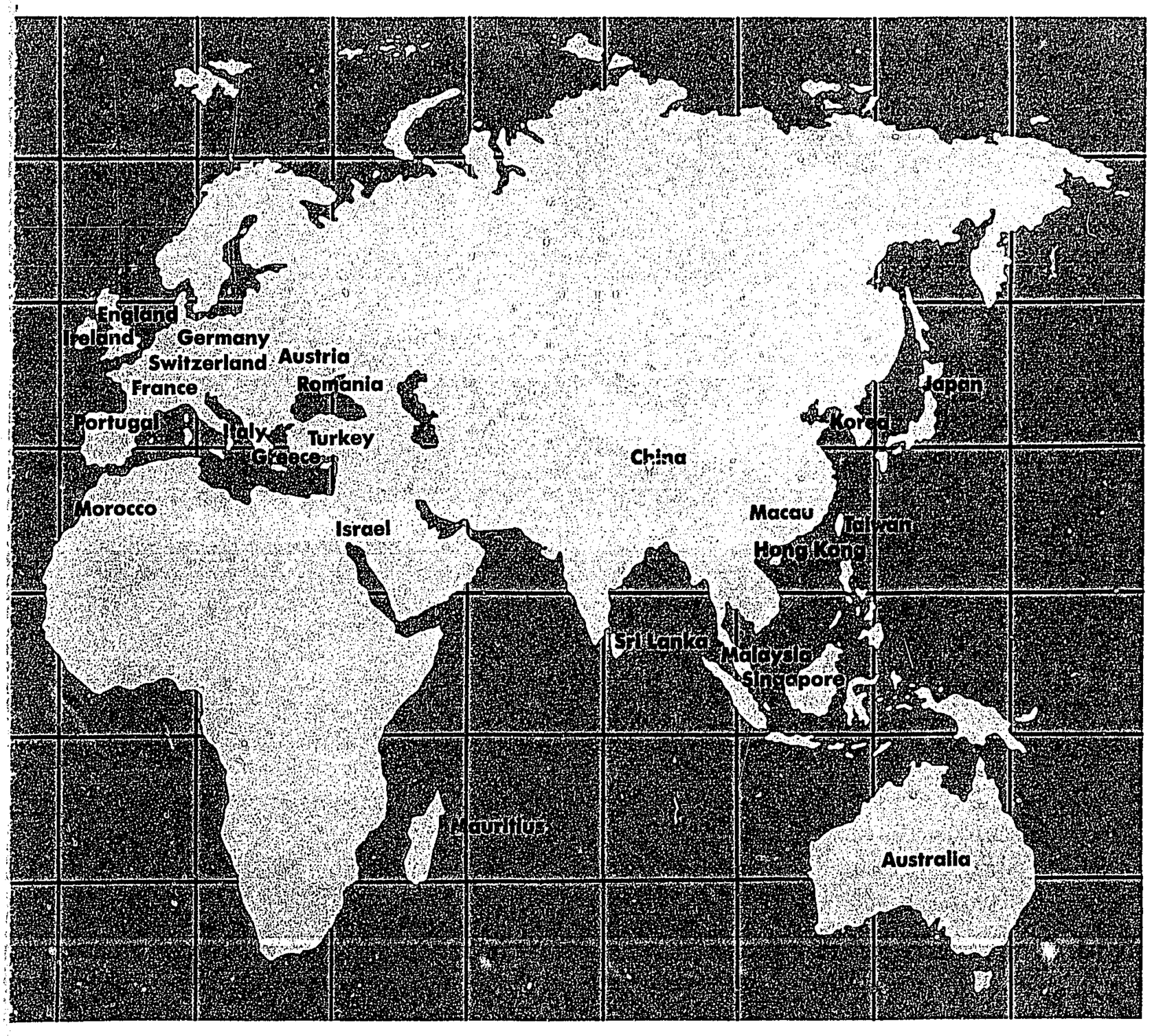
Our base of suppliers includes a worldwide network of sophisticated entrepreneurs linked by a common goal: a commitment to the timely manufacturing and delivery of quality apparel at competitive prices.





**"We use a global base to feed the fastest growing specialty businesses in the world. We will not be denied."**

**Martin Trust**
President, Mast Industries



# DISTRIBUTION SERVICES

**"I've never seen a company where people work so hard and take such pride in their work."**

**Robert H. Morosky**
Vice Chairman, The Limited, Inc.

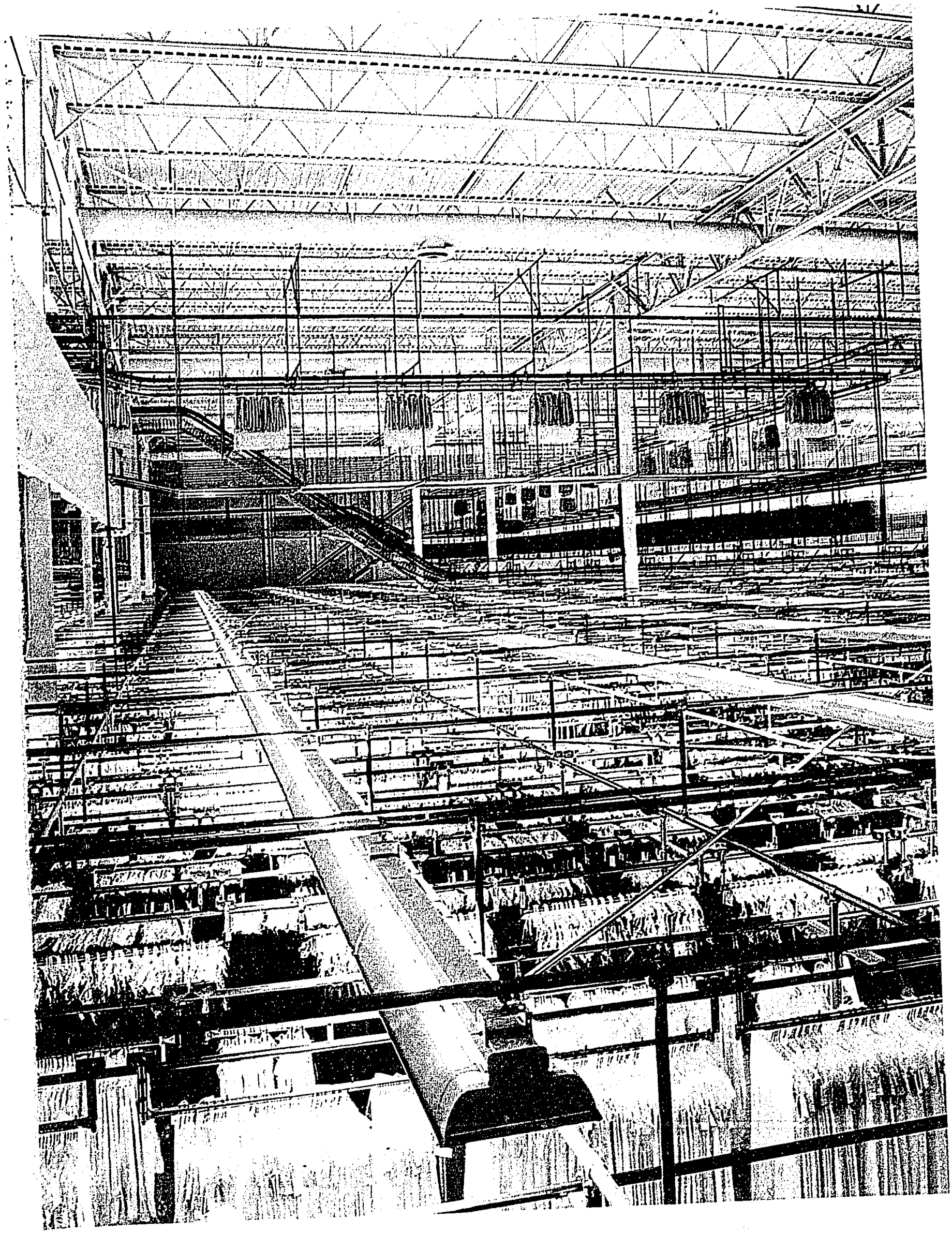


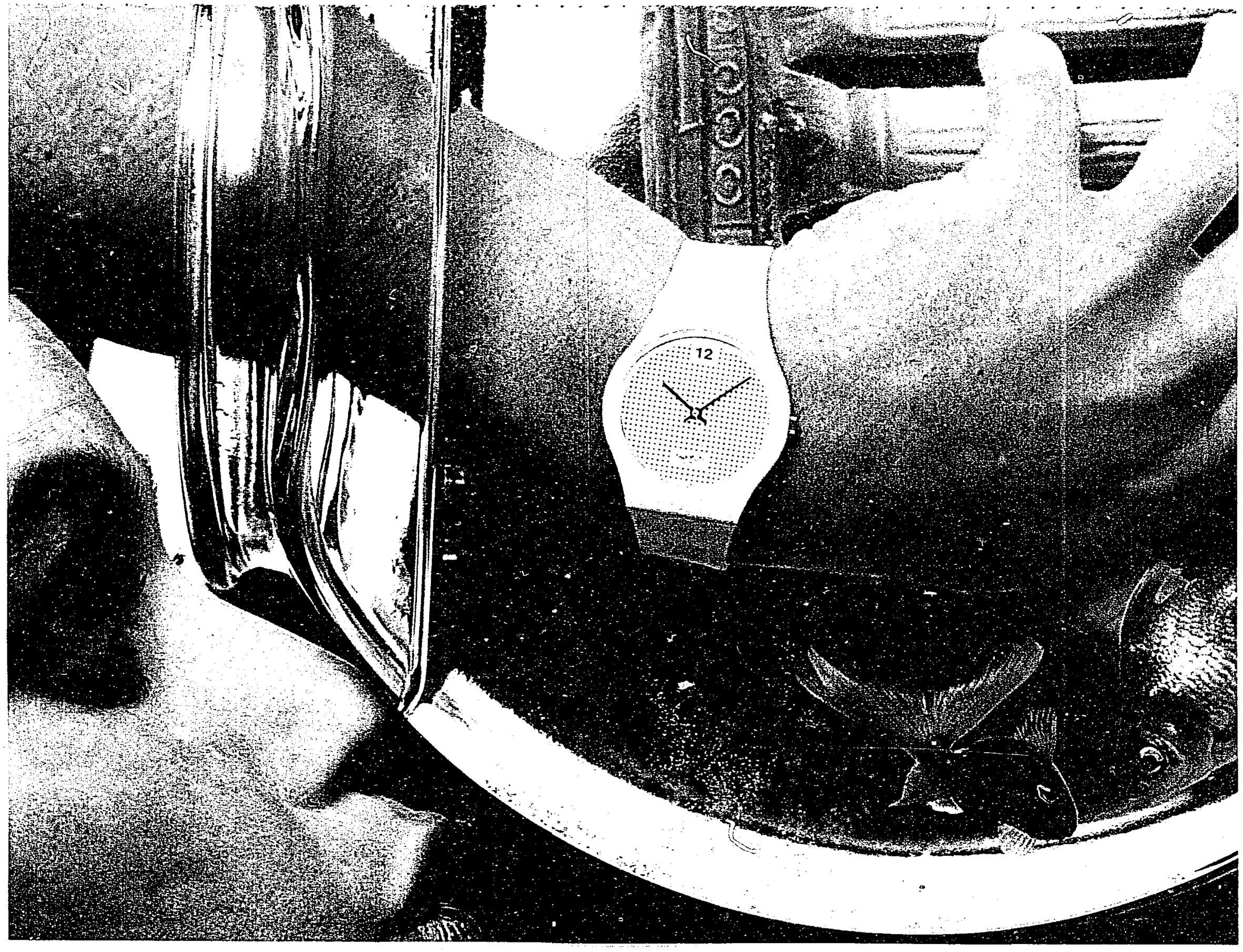
At the Distribution Center, our greatest asset is our people. We set high goals and we meet them—conscientiously, dependably and consistently—thanks to the efforts of our hard working associates. These associates are vital members of The Limited's family. They move tens of millions of pieces of fashion apparel through our distribution center annually.

Our newest 930,000 square foot distribution facility supplements the existing 535,000 square foot center—equipping us to service up to 5,000 stores from the Columbus complex.








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# Financial Report


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# Ten Year Financial Summary

(thousands except per share amounts)

| Fiscal Year | 1985† | 1984*† | 1983 | 1982† |
|---|---|---|---|---|
| **Summary of Operations** | | | | |
| Net Sales | **$2,387,110** | $1,343,134 | $1,085,890 | $721,394 |
| Gross Income | **718,843** | 404,321 | 327,616 | 209,374 |
| Operating Income | **276,212** | 173,102 | 135,377 | 70,943 |
| Income before Income Taxes | **239,317** | 157,495 | 134,939 | 60,592 |
| Net Income | **$ 145,317** | $ 92,495 | $ 70,939 | $ 33,592 |
| **Per Share Results** | | | | |
| Net Income | **$1.20** | $ .77 | $ .59 | $ .29 |
| Dividends | **.16** | .12 | .06 | .036 |
| Book Value | **3.37** | 2.31 | 1.63 | 1.05 |
| Weighted Average Number of Shares Outstanding | **121,879** | 120,421 | 120,124 | 117,004 |
| **Other Financial Information** | | | | |
| Net Income as a Percentage of Sales | **6.1%** | 6.9% | 6.5% | 4.7% |
| Working Capital | **$ 62,906** | $ 67,260 | $ 40,131 | $ 22,887 |
| Ratio of Current Assets to Current Liabilities | **1.2** | 1.4 | 1.3 | 1.2 |
| Total Assets | **$1,211,510** | $ 567,152 | $ 377,396 | $320,392 |
| Senior Long-Term Debt | **$ 213,744** | $ 60,139 | $ 21,763 | $ 74,411 |
| Subordinated Convertible Debt | **$ 175,000** | $ — | $ — | $ — |
| Shareholders' Equity | **$ 404,075** | $ 275,403 | $ 192,576 | $122,578 |
| Return on Average Shareholders' Equity | **43%** | 40% | 45% | 33% |
| Total Number of Stores Open at End of Year | **2,353** | 1,412 | 937 | 825 |

* Consists of 53 weeks.
† Includes the results of companies acquired subsequent to the date of acquisition.

| 1981 | 1980 | 1979* | 1978 | 1977 | 1976 |
|---|---|---|---|---|---|
| $364,900 | $295,016 | $252,693 | $218,876 | $175,373 | $118,002 |
| 109,246 | 81,919 | 62,749 | 53,757 | 58,863 | 38,539 |
| 38,386 | 23,191 | 12,549 | 10,813 | 25,346 | 17,514 |
| 38,486 | 20,817 | 8,588 | 7,695 | 24,817 | 17,533 |
| $ 22,386 | $ 13,142 | $ 7,063 | $ 5,920 | $ 13,217 | $ 8,833 |
| | | | | | |
| $ .20 | $ .12 | $.07 | $ .06 | $ .13 | $ .09 |
| .019 | .014 | .01 | .009 | .006 | .003 |
| .76 | .56 | .44 | .38 | .31 | .19 |
| 111,014 | 108,712 | 106,784 | 106,072 | 104,576 | 103,376 |
| | | | | | |
| 6.1% | 4.5% | 2.8% | 2.7% | 7.5% | 7.5% |
| $ 23,728 | $ 18,756 | $ 14,041 | $ 17,329 | $ 18,631 | $ 11,370 |
| 1.7 | 1.7 | 1.7 | 1.9 | 2.2 | 2.0 |
| $142,658 | $116,551 | $102,921 | $ 98,176 | $ 71,405 | $ 39,123 |
| $ 9,315 | $ 15,661 | $ 22,264 | $ 27,295 | $ 11,305 | $ 7,107 |
| $ 7,256 | $ 8,104 | $ 8,645 | $ 8,645 | $ 10,000 | $ — |
| $ 83,150 | $ 60,093 | $ 46,726 | $ 39,597 | $ 32,769 | $ 19,561 |
| 31% | 25% | 16% | 16% | 51% | 58% |
| 430 | 352 | 309 | 258 | 188 | 126 |

# Management's Discussion and Analysis of Results of Operations and Financial Condition

## RESULTS OF OPERATIONS

### FINANCIAL SUMMARY

Certain financial data expressed in percentage relationship to net sales and in comparison to the prior fiscal year are:

| | Percentage of Net Sales | | | Percentage Increase from Prior Year | |
|---|---|---|---|---|---|
| | **1985** | 1984 | 1983 | **1984-1985** | 1983-1984 |
| Net Sales | **100.0%** | 100.0% | 100.0% | **78%** | 24% |
| Gross Income | **30.1%** | 30.1% | 30.2% | **78%** | 23% |
| General, Administrative and Store Operating Expenses | **18.5%** | 17.2% | 17.7% | **91%** | 20% |
| Interest Expense | **1.7%** | 1.2% | .9% | **147%** | 63% |
| Net Income | **6.1%** | 6.9% | 6.5% | **57%** | 30% |

The results for 1985 and 1984 include the operations of companies acquired in those years subsequent to their acquisition dates. Note 7 includes certain unaudited pro forma financial information assuming that the Lerner Stores acquisition had taken place as of the beginning of 1984 and 1985.

### NET SALES

The increase in 1985 net sales largely results from the acquisition of Lerner Stores Corporation, the opening of an additional 267 stores and increased sales in existing stores. Fifty percent of the increase in 1985 net sales relates to Lerner. The increase in 1984 net sales largely results from the opening of an additional 274 stores, increased sales in existing stores and an increase in mail order sales.

### GROSS INCOME

Gross income as a percentage of net sales in 1985, 1984 and 1983 was relatively consistent. However, in 1985 and 1984, the Company experienced lower markdowns as a percentage of net sales which were offset by increases in occupancy and buying costs.

### GENERAL, ADMINISTRATIVE AND STORE OPERATING EXPENSES

These operating expenses improved in 1985 and 1984 as a percentage of net sales as a result of additional economies of scale and management's continued emphasis on expense control and reduction. However, in 1985 this improvement was offset as a result of the inclusion of Lerner's results in the Consolidated Statement of Income since the acquisition date.

### INTEREST EXPENSE

Interest expense increased in 1985 primarily because of bank debt incurred for the Lerner acquisition; convertible debt issued to finance the expansion of the Company's distribution facilities in Columbus, Ohio and Indianapolis, Indiana and to repay indebtedness incurred by Lerner Stores prior to its acquisition by the Company; and an increase in the Company's credit card receivables which were financed through finance subsidiaries' borrowings (see Note 8). Interest expense increased in 1984 primarily because, in connection with the Company's tender offer for Carter Hawley Hale, available credit lines were drawn down and the proceeds temporarily invested in marketable securities.

### OTHER INCOME

Other income in 1984 includes a pre-tax non-recurring charge of $7.3 million related to the Company's tender offer for Carter Hawley Hale, while other income in 1983 includes a pre-tax non-recurring gain of approximately $8 million related to the disposal of assets acquired with Lane Bryant.

### PROVISION FOR INCOME TAXES

The effective tax rates were 39.3%, 41.3% and 47.4% for 1985, 1984 and 1983, respectively. A reconciliation of these rates with the Federal statutory income tax rate is presented in Note 5.

### IMPACTS OF INFLATION

Note 10 describes the estimated impact of inflation on the Company's operating results and financial position in 1985. The calculations indicate that the effects of inflation on the Company have been minor.

## FINANCIAL CONDITION

### LIQUIDITY AND CAPITAL RESOURCES

Cash provided from operations and the Company's capital structure plus funds available under committed long-term bank agreements provide the financial resources and stability to support both current operations and future growth. The Company's capital structure is as follows ($000):

| | **1985** | 1984 | 1983 |
|---|---|---|---|
| Working Capital | **$ 62,906** | $ 67,260 | $ 40,131 |
| Capitalization— | | | |
| Senior long-term debt | **$213,744** | $ 60,139 | $ 21,763 |
| Subordinated convertible debt | **175,000** | — | — |
| Deferred taxes | **44,506** | 42,394 | 33,758 |
| Shareholders' equity | **404,075** | 275,403 | 192,576 |
| Total Capitalization | **$837,325** | $377,936 | $248,097 |
| Unused and available long-term bank lines | **$503,000** | $654,000 | $110,000 |

The Company considers the following to be several measures of liquidity and asset utilization:

| | **1985** | 1984 | 1983 |
|---|---|---|---|
| Cash provided from operations (000) | **$249,250** | $120,305 | $106,595 |
| Liquidity and Asset Utilization Ratios: | | | |
| Cash flow to debt (cash flow from operations divided by total current and long-term liabilities) | **33%** | 48% | 71% |
| Interest coverage (income before interest expense and taxes divided by interest expense) | **7** | 10 | 14 |
| Senior debt ratio (senior long-term debt divided by total capitalization) | **26%** | 16% | 9% |
| Cash flow to capital investment (cash flow from operations divided by additions to property and equipment) | **138%** | 102% | 205% |

As the tables indicate, the Company's primary source of liquidity continues to be cash provided from operations, which increased 107% in 1985 due primarily to increased earnings. Cash provided from operations in 1985 permitted the Company to invest $180.3 million in new property and equipment while at the same time reducing the debt incurred from the acquisition of Lerner and establishing a new finance subsidiary.

The acquisition of Lerner caused the Company's senior debt ratio to increase to 51% at May 4, 1985 from 16% at February 2, 1985. However, earnings and the proceeds of two subordinated convertible debt offerings ($125 million of 7½% Subordinated Convertible Debentures and $50 million of 6¾% Subordinated Convertible Bonds) reduced the senior debt ratio to 26% at February 1, 1986. As a consequence, the Company's liquidity and borrowing capacity has not been adversely impacted by the increase in the senior debt ratio.

The Company has available under its revolving credit agreements long-term bank lines totaling $700 million, of which $503 million was unused at February 1, 1986. These agreements provide for additional financial stability and seasonal working capital needs. Management believes that the Company's liquidity and capital resources are sufficient to sustain current operations and provide for future economic growth.

### CAPITAL REQUIREMENTS

Capital additions in 1985, 1984 and 1983 amounted to $180.3 million, $117.7 million and $52.0 million, respectively. These expenditures were for new store construction and renovation plus equipment additions and, in 1984, construction of new distribution and shipping facilities. Capital additions of approximately $175 million are planned for 1986, including the addition of approximately 375 new stores and the remodeling of existing stores. The Company anticipates that these capital additions will not require external financing.

Sales are typically for cash, through national bank credit cards or the Company's credit cards. Management believes that sales growth can be supported without the need for significant increases in working capital because the Company's credit card receivables are sold to wholly-owned, unconsolidated finance subsidiaries (see Note 8), and inventory turnover is rapid.

# Consolidated Statement of Income

(thousands except per share amounts)

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| **Net Sales** | **$2,387,110** | $1,343,134 | $1,085,890 |
| Costs of Goods Sold, Occupancy and Buying Costs | **1,668,267** | 938,813 | 758,274 |
| **Gross Income** | **718,843** | 404,321 | 327,616 |
| General, Administrative and Store Operating Expenses | **442,631** | 231,219 | 192,239 |
| **Operating Income** | **276,212** | 173,102 | 135,377 |
| Interest Expense | **(41,230)** | (16,662) | (10,248) |
| Other Income, net | **4,335** | 1,055 | 9,810 |
| **Income Before Income Taxes** | **239,317** | 157,495 | 134,939 |
| Provision for Income Taxes | **94,000** | 65,000 | 64,000 |
| **Net Income** | **$ 145,317** | $ 92,495 | $ 70,939 |
| **Net Income Per Share** | **$1.20** | $.77 | $.59 |

The accompanying Summary of Significant Accounting Policies and notes are an integral part of this statement.

# Consolidated Balance Sheet

(thousands)

| Assets | February 1, 1986 | February 2, 1985 |
|---|---|---|
| **Current Assets** | | |
| Cash and Equivalents | **$ 12,948** | $ 7,494 |
| Accounts Receivable | **62,077** | 45,912 |
| Inventories | **320,305** | 190,014 |
| Prepayments and Other | **20,994** | 13,056 |
| **Total Current Assets** | **416,324** | 256,476 |
| **Property and Equipment** | **648,314** | 267,528 |
| **Investment in and Advances to Finance Subsidiaries** | **74,795** | 23,672 |
| **Other Assets** | **72,077** | 19,476 |
| **Total Assets** | **$1,211,510** | $567,152 |

| Liabilities and Shareholders' Equity | February 1, 1986 | February 2, 1985 |
|---|---|---|
| **Current Liabilities** | | |
| Accounts Payable | **$ 134,368** | $103,010 |
| Accrued Expenses | **103,381** | 47,719 |
| Income Taxes Payable | **9,253** | 9,378 |
| Deferred Income Taxes | **56,416** | 29,109 |
| **Total Current Liabilities** | **353,418** | 189,216 |
| **Senior Long-Term Debt** | **213,744** | 60,139 |
| **Subordinated Convertible Debt** | **175,000** | — |
| **Deferred Income Taxes** | **44,506** | 42,394 |
| **Other Long-Term Liabilities** | **20,767** | — |
| **Shareholders' Equity** | | |
| Common Stock | **59,917** | 29,807 |
| Paid-in Capital | **24,695** | 22,466 |
| Retained Earnings | **319,463** | 223,130 |
| **Total Shareholders' Equity** | **404,075** | 275,403 |
| **Total Liabilities and Shareholders' Equity** | **$1,211,510** | $567,152 |

The accompanying Summary of Significant Accounting Policies and notes are an integral part of this statement.

# Consolidated Statement of Shareholders' Equity (thousands)

| | Common Stock | | | |
|---|---|---|---|---|
| | Shares Outstanding | Par Value | Paid-in Capital | Retained Earnings |
| **Balance, January 29, 1983** | **29,216** | **$14,608** | **$12,267** | **$ 95,703** |
| Net income | — | — | — | 70,939 |
| Cash dividends | — | — | — | (7,056) |
| Exercise of stock options and other | 588 | 294 | 5,821 | — |
| Two-for-one stock split | 29,376 | 14,688 | — | (14,688) |
| **Balance, January 28, 1984** | **59,180** | **29,590** | **18,088** | **144,898** |
| Net income | — | — | — | 92,495 |
| Cash dividends | — | — | — | (14,263) |
| Exercise of stock options and other | 434 | 217 | 4,378 | — |
| **Balance, February 2, 1985** | **59,614** | **29,807** | **22,466** | **223,130** |
| Net income | — | — | — | 145,317 |
| Cash dividends | — | — | — | (19,118) |
| Exercise of stock options and other | 488 | 244 | 2,229 | — |
| Two-for-one stock split | 59,732 | 29,866 | — | (29,866) |
| **Balance, February 1, 1986** | **119,834** | **$59,917** | **$24,695** | **$319,463** |

The accompanying Summary of Significant Accounting Policies and notes are an integral part of this statement.

# Consolidated Statement of Changes in Financial Position (thousands)

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| **Cash was provided from:** | | | |
| Operations | | | |
| Net income | **$145,317** | $ 92,495 | $ 70,939 |
| Add expenses not requiring working capital | | | |
| Depreciation and amortization | **80,128** | 34,526 | 28,427 |
| Deferred income taxes and other | **(3,030)** | 7,587 | 12,511 |
| Working capital from operations | **222,415** | 134,608 | 111,877 |
| Cash flow additions (requirements) resulting from | | | |
| Inventories | **(51,342)** | (67,157) | (20,698) |
| Payables | **62,567** | 36,240 | 2,147 |
| Income taxes | **11,082** | 16,326 | 8,779 |
| Other current assets and liabilities | **4,528** | 288 | 4,490 |
| **Cash provided from operations** | **249,250** | 120,305 | 106,595 |
| Other sources of cash | | | |
| Subordinated convertible debt | **175,000** | — | — |
| Other long-term debt | **346,590** | 38,290 | — |
| Disposal of assets | **8,323** | 2,716 | 25,252 |
| **Total cash provided** | **779,163** | 161,311 | 131,847 |
| **Cash was used for:** | | | |
| Net cash to acquire subsidiaries and retire debt | **331,462** | 14,142 | 24,493 |
| Reduction of long-term debt | **196,398** | — | 52,648 |
| Investment in property and equipment | **180,269** | 117,684 | 52,016 |
| Investment in and advances to finance subsidiaries | **47,456** | 8,000 | — |
| Cash dividends | **19,118** | 14,263 | 7,056 |
| Other, net | **(994)** | 1,010 | (159) |
| **Total cash used** | **773,709** | 155,099 | 136,054 |
| **Increase (decrease) in Cash and Equivalents** | **5,454** | 6,212 | (4,207) |
| Cash and Equivalents, beginning of year | **7,494** | 1,282 | 5,489 |
| **Cash and Equivalents, end of year** | **$ 12,948** | $ 7,494 | $ 1,282 |

The accompanying Summary of Significant Accounting Policies and notes are an integral part of this statement.

# Summary of Significant Accounting Policies

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiaries except the Company's wholly-owned finance subsidiaries, which are accounted for as equity investments (Note 8).

### FISCAL YEAR

Fiscal years are designated in the financial statements and notes by the calendar year in which the fiscal year commences. Accordingly, results for fiscal years 1985, 1984 and 1983 represent the 52 weeks ended February 1, 1986, the 53 weeks ended February 2, 1985 and the 52 weeks ended January 28, 1984, respectively.

### INVENTORIES

Inventories are principally valued at the lower of average cost or market.

### CATALOG COSTS

Catalog preparation and printing costs are principally charged to expense in the year incurred.

### PROPERTY AND DEPRECIATION

Depreciation and amortization of property and equipment are computed for financial reporting purposes on a straight-line basis, using average service lives of 25 years for buildings and improvements and 8 years for other property and equipment. The cost of assets sold or retired and the related accumulated depreciation or amortization are removed from the accounts in the year of disposal, and any gain or loss is included in net income. Maintenance, repairs and minor renewals are charged to expense as incurred. Renewals and betterments which extend service lives are capitalized.

### INCOME TAXES

The provision for income taxes is based on income reported for financial statement purposes, and includes a deferred provision for the tax effect of timing differences between the financial and tax reporting of revenue and expense items. Deferred income taxes included in current liabilities result principally from installment method recognition, for tax purposes, of sales from the Company's credit card operations. Deferred Federal income taxes, less applicable foreign tax credits, have not been provided on the undistributed earnings of foreign subsidiaries ($56.9 million at February 1, 1986) because the Company intends to reinvest such undistributed earnings in those operations. Investment tax credits are accounted for as a reduction of the provision for Federal income taxes in the year the related assets are placed in service.

### SHAREHOLDERS' EQUITY

Two hundred million shares of $.50 par value common stock are authorized of which 119.8 million are issued and outstanding. Ten million shares of $1.00 par value preferred stock are authorized, none of which has been issued.

### NET INCOME PER SHARE

Net income per share is computed based upon the weighted average number of outstanding common shares and equivalents (including stock options and the Subordinated Convertible Bonds), as restated for two-for-one stock splits in 1983 and 1985. The effect on net income per share resulting from the assumed conversion of the Subordinated Convertible Debentures is not material.

# Notes to Consolidated Financial Statements

(thousands except share amounts)

## (1) LEASED FACILITIES AND COMMITMENTS

Annual store rent is a fixed minimum amount, plus contingent rent based on a percentage of sales exceeding a stipulated amount. Store lease provisions generally require additional payments covering taxes, maintenance and other miscellaneous expenses. Rent expense was as follows:

| | **1985** | 1984 | 1983 |
|---|---|---|---|
| Store rent— | | | |
| Fixed minimum | **$ 98,996** | $47,550 | $36,429 |
| Contingent | **14,368** | 6,695 | 4,781 |
| Total store rent | **113,364** | 54,245 | 41,210 |
| Equipment & other | **15,887** | 11,249 | 8,882 |
| Total rent expense | **$129,251** | $65,494 | $50,092 |

At February 1, 1986, the Company was committed under store leases with initial terms ranging from ten to twenty years, averaging twelve years.

Minimum rent commitments by fiscal year for noncancellable leases are as follows:

| | |
|---|---|
| 1986 | $134,358 |
| 1987 | 131,270 |
| 1988 | 124,938 |
| 1989 | 116,784 |
| 1990 | 112,167 |
| Thereafter | 473,231 |

## (2) FINANCING ARRANGEMENTS

### LONG-TERM DEBT

Senior long-term debt consisted of:

| | **1985** | 1984 |
|---|---|---|
| Revolving credit agreements (a) | **$197,000** | $46,000 |
| Other, net of current maturities | **16,744** | 14,139 |
| | **$213,744** | $60,139 |

Subordinated convertible debt consisted of:

| | **1985** | 1984 |
|---|---|---|
| Subordinated convertible debentures (b) | **$125,000** | $ — |
| Subordinated convertible bonds (c) | **50,000** | — |
| | **$175,000** | $ — |

(a) Under its Revolving Credit and Term Loan Agreements, the Company has the right to borrow up to $700 million through April 30, 1989, at which time the then outstanding balance will be repaid in eight semi-annual installments commencing October 31, 1989. At the Company's option, interest is payable at either an agreed upon amount over the lenders' cost of funds or the prime rate. Commitment fees on the unused lines vary depending on usage with an average rate of ¼ of 1%. The terms of the Agreements place certain restrictions on the Company including retained earnings available for dividends and the purchase, redemption or retirement of the Company's stock. As of February 1, 1986, $60 million of retained earnings was free from such limitation.

(b) In July 1985, the Company issued $125 million of 7½% Subordinated Convertible Debentures (at par) due July 1, 2010. The debentures are convertible into shares of the Company's common stock at $31⅜ per share. The debentures are redeemable before January 1, 1988 upon certain conditions, and thereafter at specified redemption prices. The Company is required to redeem $4.5 million of the debentures annually commencing July 1, 1996.

(c) In August 1985, the Company issued $50 million of 6¾% Subordinated Convertible Bonds (at par) due August 15, 2000. The bonds are convertible into shares of the Company's common stock at $32 per share. The bonds are redeemable before August 15, 1990 upon certain conditions, and thereafter at specified redemption prices. On August 15, 1990, each bondholder has the option of requiring the Company to redeem the bonds at 116½% of the principal amount.

Aggregate maturities of long-term debt during the next five years are:

| | |
|---|---|
| 1986 (current maturities, included in accounts payable) | $ 2,814 |
| 1987 | 1,767 |
| 1988 | 2,736 |
| 1989 | 26,328 |
| 1990 | 50,263 |

# Notes to Consolidated Financial Statements

(thousands except share amounts)

## (3) ACCOUNTS RECEIVABLE

Accounts receivable consisted of:

| | 1985 | 1984 |
|---|---|---|
| Accounts receivable, principally deferred payment accounts | **$448,317** | $176,566 |
| Accounts sold to wholly-owned finance subsidiaries (Note 8) | **(369,066)** | (126,378) |
| Allowance for uncollectible accounts | **(17,174)** | (4,276) |
| | **$ 62,077** | $ 45,912 |

Finance charge revenue on deferred payment accounts amounted to $38.6 million and $20.2 million in 1985 and 1984, respectively, and is classified as a reduction to the cost of administering the deferred payment program which is included in general, administrative and store operating expenses.

## (4) PROPERTY AND EQUIPMENT

Property and equipment at cost consisted of:

| | 1985 | 1984 |
|---|---|---|
| Land, buildings and improvements | **$ 84,956** | $ 30,975 |
| Furniture, fixtures and equipment | **377,002** | 204,790 |
| Leaseholds and improvements | **340,881** | 100,155 |
| Construction in progress | **28,919** | 44,313 |
| | **831,758** | 380,233 |
| Less—Accumulated depreciation and amortization | **183,444** | 112,705 |
| Property and Equipment, net | **$648,314** | $267,528 |

## (5) INCOME TAXES

The provision for income taxes consisted of:

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| Currently payable: | | | |
| Federal | **$41,900** | $35,600 | $36,900 |
| State | **7,000** | 4,000 | 7,200 |
| Foreign | **4,200** | 2,700 | 1,300 |
| | **53,100** | 42,300 | 45,400 |
| Deferred: | | | |
| Federal | **35,100** | 19,700 | 15,100 |
| State | **5,800** | 3,000 | 3,500 |
| | **40,900** | 22,700 | 18,600 |
| Total Provision | **$94,000** | $65,000 | $64,000 |

The foreign component of pre-tax income in 1985, 1984 and 1983 was $28,200, $14,900 and $9,200, respectively.

The components of the deferred tax provision are as follows:

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| Deferred profit on receivables | **$43,700** | $10,000 | $ 5,200 |
| Excess of tax depreciation over book depreciation | **2,200** | 6,700 | 3,100 |
| Accelerated tax deductions from the acquisition of businesses | **2,900** | 4,600 | 5,600 |
| Employee benefit plans | **(5,100)** | 1,100 | 4,000 |
| Other, net | **(2,800)** | 300 | 700 |
| | **$40,900** | $22,700 | $18,600 |

Reconciliation of the effective income tax rate with the statutory Federal income tax rate is as follows:

| | 1985 | 1984 | 1983 |
|---|---|---|---|
| Federal income tax rate | **46.0%** | 46.0% | 46.0% |
| State income tax, net of Federal income tax effect | **2.9** | 2.4 | 4.3 |
| Investment tax credits | **(2.7)** | (2.9) | (1.4) |
| Foreign operations | **(4.0)** | (2.7) | (2.1) |
| Other, net | **(2.9)** | (1.5) | .6 |
| | **39.3%** | 41.3% | 47.4% |

## (6) STOCK OPTIONS

Under the Company's stock option plans at February 1, 1986, 4.8 million shares were available for grant to employees. An additional 2.3 million shares were reserved for outstanding options, of which 1.1 million were exercisable. Options have been granted at fair market value. Option activity for the year ended February 1, 1986, adjusted to reflect the 1985 stock split, was as follows:

| | Number of Shares | Weighted Average Option Price Per Share |
|---|---|---|
| Outstanding Options, February 2, 1985 | 2,513,000 | $ 5.78 |
| Activity during 1985 | | |
| Granted | 478,000 | $21.02 |
| Exercised | (606,000) | $ 4.07 |
| Cancelled | (117,000) | $12.83 |
| Outstanding Options, February 1, 1986 | 2,268,000 | $ 9.08 |

At February 2, 1985, 5.2 million shares were available for grant to employees.

## (7) ACQUISITIONS

In April 1985, the Company completed the acquisition of Lerner Stores Corporation for $297 million in cash. The acquisition was accounted for as a purchase, and accordingly, the results of Lerner's operations since the acquisition date are included in the Company's Consolidated Statement of Income. Intangible assets resulting from the acquisition of Lerner are being amortized on a straight-line basis over 40 years. The following table presents selected unaudited pro forma financial information for 1984 and 1985 as if the acquisition had taken place at the beginning of those years.

| | 1985 | | 1984 | |
|---|---|---|---|---|
| | As Reported | Pro Forma | As Reported | Pro Forma |
| Net Sales | $2,387,110 | $2,488,380 | $1,343,134 | $2,033,061 |
| Operating Income | 276,212 | 277,658 | 173,102 | 196,006 |
| Interest Expense | 41,230 | 46,946 | 16,662 | 58,604 |
| Net Income | $ 145,317 | $ 143,456 | $ 92,495 | $ 85,721 |
| Net Income Per Share | $1.20 | $1.18 | $.77 | $.71 |

This required pro forma information includes adjustments to reflect additional interest expense, depreciation and amortization, but does not reflect the impact of operating changes already made or planned to be made. In management's opinion, these results are not indicative of the results that would have occurred during 1984 and 1985 had the acquisition taken place at the beginning of those years.

In October 1985, the Company acquired the assets of Henri Bendel, a women's apparel specialty store. In September 1984, the Company acquired Pic-A-Dilly, Inc., a women's apparel retailer, for approximately $14.1 million in cash. Pic-A-Dilly's operations have been discontinued and all of the stores have been converted to other retail formats. These acquisitions were accounted for as purchases, and accordingly, the results of their operations since the acquisition dates are included in the Company's Consolidated Statement of Income. The impact of these acquisitions is not material to the Company's Consolidated Statement of Income.

## (8) FINANCE SUBSIDIARIES

Limited Credit Corp. and Limited Credit Funding, Inc., wholly-owned unconsolidated finance subsidiaries formed in 1982 and 1985, respectively, purchase, without recourse, receivables generated by the Company's credit card operations. The purchases are financed through borrowings under Revolving Credit and Term Loan Agreements totaling $100 million for Limited Credit Corp. and a $200 million receivable finance facility for Limited Credit Funding, Inc. The receivables are generally purchased at discounts sufficient to cover fixed charges (principally interest expense) at least one and one-half times. These discounts are eliminated in the Consolidated Statement of Income by reducing interest expense in an amount equal to the pre-tax earnings of the finance subsidiaries. Combined net earnings of the finance subsidiaries totaled $3.6 million, $1.9 million and $1.3 million in 1985, 1984 and 1983, respectively. A combined condensed balance sheet of the finance subsidiaries reflecting the elimination of all intercompany items is presented below.

### ASSETS

| | **February 1, 1986** | February 2, 1985 |
|---|---|---|
| Customer receivables purchased from wholly-owned subsidiaries of The Limited, Inc. | **$369,100** | $126,400 |

### LIABILITIES AND INVESTMENT

| | | |
|---|---|---|
| Borrowings under credit agreements | **$282,000** | $ 90,000 |
| Subordinated debt to affiliate | **28,500** | 8,000 |
| Contract withholding account and other | **12,300** | 12,700 |
| | **322,800** | 110,700 |
| Investment of The Limited, Inc. (including accumulated earnings of $7,300 and $3,700) | **46,300** | 15,700 |
| | **$369,100** | $126,400 |

# Notes to Consolidated Financial Statements

(thousands except share amounts)

The provisions of the borrowings place restrictions on the finance subsidiaries, including retained earnings available for dividends and for the purchase, redemption or retirement of the finance subsidiaries' stock. As of February 1, 1986, $4.1 million of the finance subsidiaries' retained earnings was free from such limitation. Borrowings under the receivable finance facility, $200 million at February 1, 1986, are secured by a lien on Limited Credit Funding's receivables equal to 125% of the amount borrowed.

The subordinated debt to affiliate is payable under $45 million of Revolving Subordinated Demand Promissory Notes. The notes call for quarterly payments of interest at 12% per annum with principal repayment due one year and one day after demand.

## (9) QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized quarterly financial results, adjusted to reflect the 1985 two-for-one stock split, are as follows:

| Fiscal Quarter | First | Second | Third | Fourth |
|---|---|---|---|---|
| 1985 | | | | |
| Net Sales | $461,115 | $525,444 | $613,331 | $787,220 |
| Gross Income | 134,737 | 155,129 | 190,129 | 238,848 |
| Net Income | 21,346 | 25,744 | 42,120 | 56,107 |
| Net Income Per Share | .18 | .21 | .35 | .46 |
| 1984 | | | | |
| Net Sales | $270,556 | $290,243 | $348,597 | $433,738 |
| Gross Income | 74,481 | 85,121 | 109,553 | 135,166 |
| Net Income | 13,605 | 16,888 | 28,385 | 33,617 |
| Net Income Per Share | .11 | .14 | .24 | .28 |

Other income in the fourth quarter of 1984 includes a non-recurring charge of $7.3 million related to a tender offer for Carter Hawley Hale Stores, Inc.

## (10) SUPPLEMENTAL INFORMATION ON INFLATION AND CHANGING PRICES (UNAUDITED)

The financial statements included in this annual report have been prepared using historical costs. Generally accepted accounting principles also require that the Company present supplemental information describing the effects of inflation on selected finaricial data, principally inventories and property and equipment, utilizing changes in specific prices, commonly referred to as the "current costs" method of measuring inflation. This method inherently involves the use of assumptions, approximations and estimates and, therefore, the resulting measurements should be viewed as estimates rather than as precise indicators of the effects of inflation.

In the following Consolidated Statement of Income Adjusted For Changing Prices for the year ended February 1, 1986, the adjustments described above have only been made for the estimated effects of inflation on the cost of property and equipment. Net sales and all other operating expenses are considered to reflect average price levels for the year, and accordingly, have not been adjusted. Likewise, the provision for income taxes has not been adjusted, since current income tax laws do not allow for adjustments to taxable income for the effects of inflation. As a result, income taxes computed as a percentage of adjusted earnings reflect a higher effective tax rate than actually imposed on the Company's earnings.

At February 1, 1986, the current costs of inventory and property and equipment, net of accumulated depreciation, were $320.3 million and $655.8 million, respectively. Depreciation expense charged to operations was $80.1 million in historical dollars, and $81.0 million at current cost.

## CONSOLIDATED STATEMENT OF INCOME ADJUSTED FOR CHANGING PRICES FOR THE YEAR ENDED FEBRUARY 1, 1986

| | As Reported | Adjusted for Changes in Specific Prices (Current Cost) |
|---|---|---|
| Net Sales | $2,387,110 | $2,387,110 |
| Cost of goods sold, occupancy and buying costs | 1,668,267 | 1,668,290 |
| Gross income | 718,843 | 718,820 |
| General, administrative and store operating expenses | 442,631 | 443,466 |
| Operating income | 276,212 | 275,354 |
| Interest expense | (41,230) | (41,230) |
| Other income, net | 4,335 | 4,335 |
| Income before income taxes | 239,317 | 238,459 |
| Provision for income taxes | 94,000 | 94,000 |
| Net income | $ 145,317 | $ 144,459 |
| Net income per share | $1.20 | $1.19 |

The following Five Year Comparison of Selected Financial Data Adjusted for Changing Prices reflects certain historical cost information adjusted to average 1985 dollars based upon the change in the average Consumer Price Index.

## FIVE YEAR COMPARISON OF SELECTED FINANCIAL DATA ADJUSTED FOR CHANGING PRICES (EXPRESSED IN AVERAGE 1985 DOLLARS)

| | 1985 | 1984 | 1983 | 1982 | 1981 |
|---|---|---|---|---|---|
| Average Consumer Price Index ("CPI") | **321.5** | 309.5 | 298.4 | 290.0 | 274.2 |
| Historical information adjusted for change in CPI: | | | | | |
| Net sales | **$2,387,110** | $1,395,516 | $1,169,504 | $800,026 | $428,028 |
| Dividends per share | **.16** | .125 | .065 | .04 | .025 |
| Market price per common share at year-end | **34¼** | 16¼ | 11⅜ | 6⅛ | 2⅛ |
| Historical information adjusted for changes in specific prices (current cost) and, for years prior to 1985, an additional adjustment for the change in the CPI: | | | | | |
| Net income | **144,459** | 93,677 | 75,486 | 37,832 | |
| Net income per share | **1.19** | .78 | .63 | .32 | |
| Net assets at year-end | **411,526** | 302,638 | 213,512 | 141,484 | |
| Effects of general inflation: | | | | | |
| Excess of assumed increase in general inflation per the CPI over increase in specific prices (current cost) | **35,400** | 8,700 | 9,000 | 5,800 | |
| Gain from decline in purchasing power of net amounts owed | **16,200** | 6,900 | 5,500 | 3,100 | |

# Report of Independent Public Accountants

To The Limited, Inc.:

We have examined the consolidated balance sheet of THE LIMITED, INC. (a Delaware corporation) and subsidiaries as of February 1, 1986 and February 2, 1985, and the related consolidated statements of income, shareholders' equity and changes in financial position for each of the three fiscal years in the period ended February 1, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of The Limited, Inc. and subsidiaries as of February 1, 1986 and February 2, 1985, and the results of their operations and the changes in their financial position for each of the three fiscal years in the period ended February 1, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR ANDERSEN & CO.

Chicago, Illinois
February 18, 1986

# Market Price and Dividend Information

| | Market Price* High | Market Price* Low | Cash Dividend Per Share* |
|---|---|---|---|
| Fiscal Year 1984 | | | |
| 1st Quarter | $11 7/8 | $ 9 5/8 | $.03 |
| 2nd Quarter | 10 3/8 | 8 1/8 | .03 |
| 3rd Quarter | 13 5/8 | 10 3/8 | .03 |
| 4th Quarter | 16 1/2 | 12 3/8 | .03 |
| Fiscal Year 1985 | | | |
| 1st Quarter | $20 3/4 | $15 3/4 | $.04 |
| 2nd Quarter | 27 5/8 | 20 5/8 | .04 |
| 3rd Quarter | 27 3/8 | 22 3/4 | .04 |
| 4th Quarter | 34 7/8 | 27 3/8 | .04 |

*Adjusted to reflect a June 1985 two-for-one stock split.

The Company's common stock is traded on the New York Stock Exchange ("LTD") and the London Stock Exchange. On February 1, 1986, there were 10,700 shareholders of record.

# Directors and Officers

## DIRECTORS

**Leslie H. Wexner** (a)
Chairman of the Board

**Robert H. Morosky** (a)
Vice Chairman

**Bella Wexner**
Secretary

**David T. Kollat**
Executive Vice President
The Limited, Inc.

**Martin Trust**
President, Mast Industries, Inc.

**W. Arthur Cullman**
Professor Emeritus of Marketing
The Ohio State University

**John W. Kessler** (a), (b)
Real Estate Consultant and Developer

**Claudine Malone** (b)
Consultant

**John K. Pfahl** (b)
Management Consultant

**Donald B. Shackelford** (b)
Chairman of the Board of State Savings Bank

**Raymond Zimmerman**
Chairman of the Board and President
Service Merchandise Co., Inc.

(a) Member of Executive Committee
(b) Member of Audit Committee

## EXECUTIVE OFFICERS

**Leslie H. Wexner**
Chairman of the Board

**Robert H. Morosky**
Vice Chairman

**Bella Wexner**
Secretary

**Thomas G. Hopkins**
Executive Vice President
Organizational Development

**David T. Kollat**
Executive Vice President
Marketing

**Jerald Dick**
Vice President
Real Estate

**Alfred S. Dietzel**
Vice President
Financial and Public Relations

**Kenneth B. Gilman**
Vice President
Corporate Controller

**Charles W. Hinson**
Vice President
Store Planning

**Timothy B. Lyons**
Vice President
Taxes

**Michael W. Solly**
Vice President
Treasurer



**Leslie H. Wexner**
Chairman



**Robert H. Morosky**
Vice Chairman



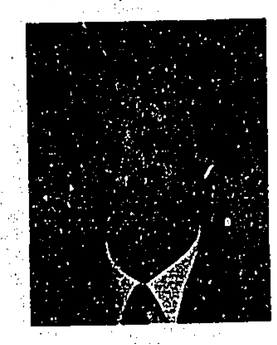
**Verna Gibson**
President, Limited Stores



**Michael A. Weiss**
President, Limited Express



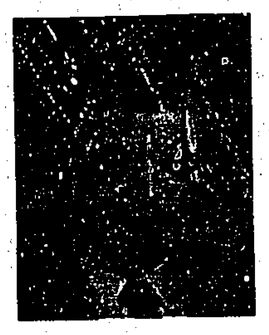
**Robert C. Grayson**
President, Lerner Stores



**Howard Gross**
President, Victoria's Secret



**Ira Quint**
President, Lane Bryant



**Raphael Benaroya**
President, Sizes Unlimited



**Peter J. Canzone**
President, Brylane



**Geraldine Stutz**
President, Henri Bendel



**Martin Trust**
President, Mast Industries

# Corporate Information

**CORPORATE OFFICES**
Two Limited Parkway
P.O. Box 16000
Columbus, OH 43216

**ANNUAL MEETING**
The Annual Meeting of Shareholders is scheduled for 9 a.m. Monday, May 19, 1986, at the Corporate Offices.

**DATE FOUNDED 1963**

**NUMBER OF ASSOCIATES 25,300**

**NUMBER OF SHAREHOLDERS OF RECORD 10,700**

**OVERSEAS OFFICES**
Osaka, Japan
Kowloon, Hong Kong
Seoul, Korea
Taipei, Taiwan
London, England

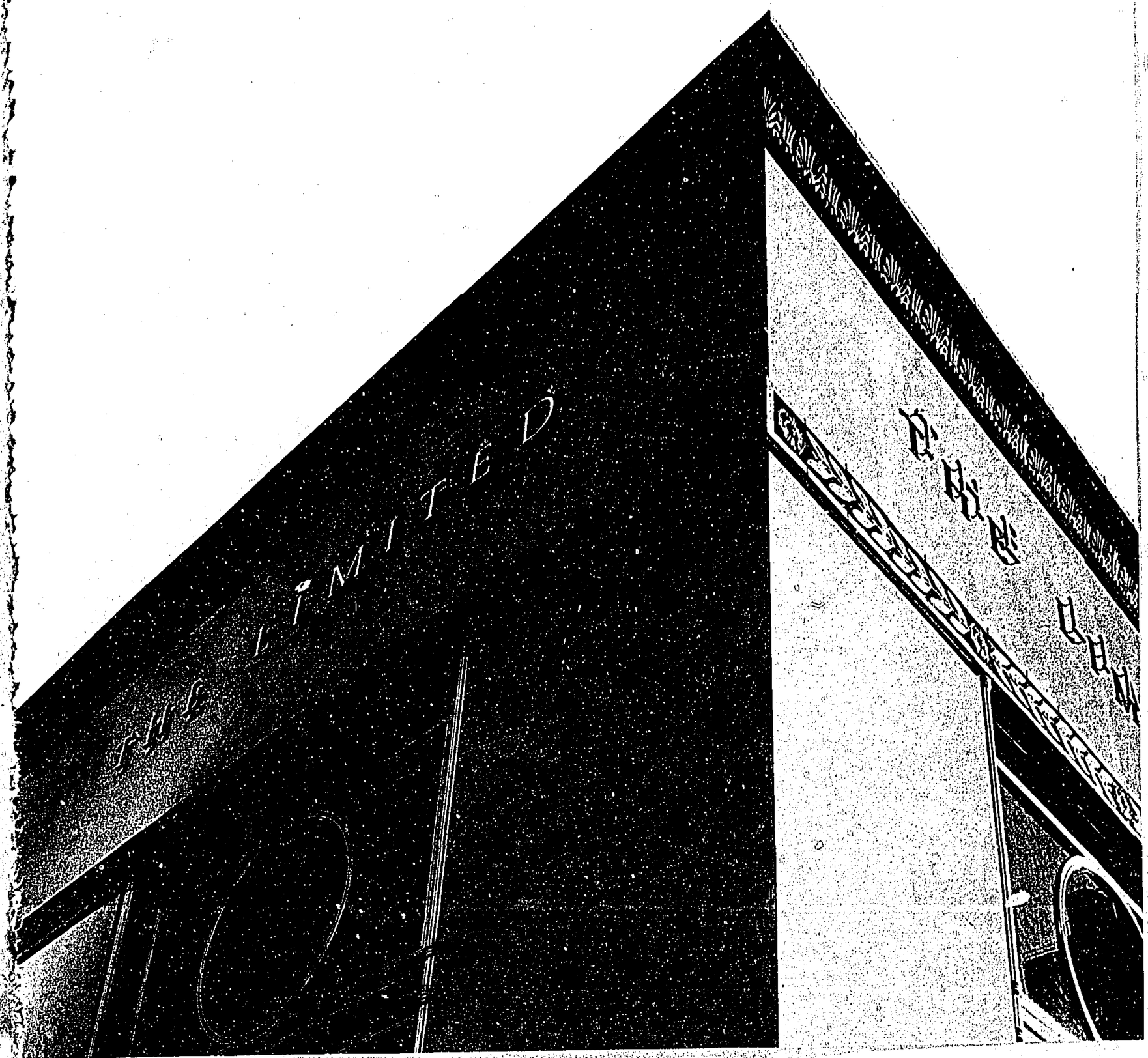
**10-K REPORT**
A form 10-K is available without charge upon written request to Alfred S. Dietzel, Vice President, The Limited, Inc., Two Limited Parkway, P.O. Box 16000, Columbus, OH 43216

**STOCK TRANSFER AGENT, REGISTRAR AND DIVIDEND AGENT**
Manufacturers Hanover Trust Company
Shareholders Relations Department
450 West 33rd Street, 8th Floor
New York, New York 10001

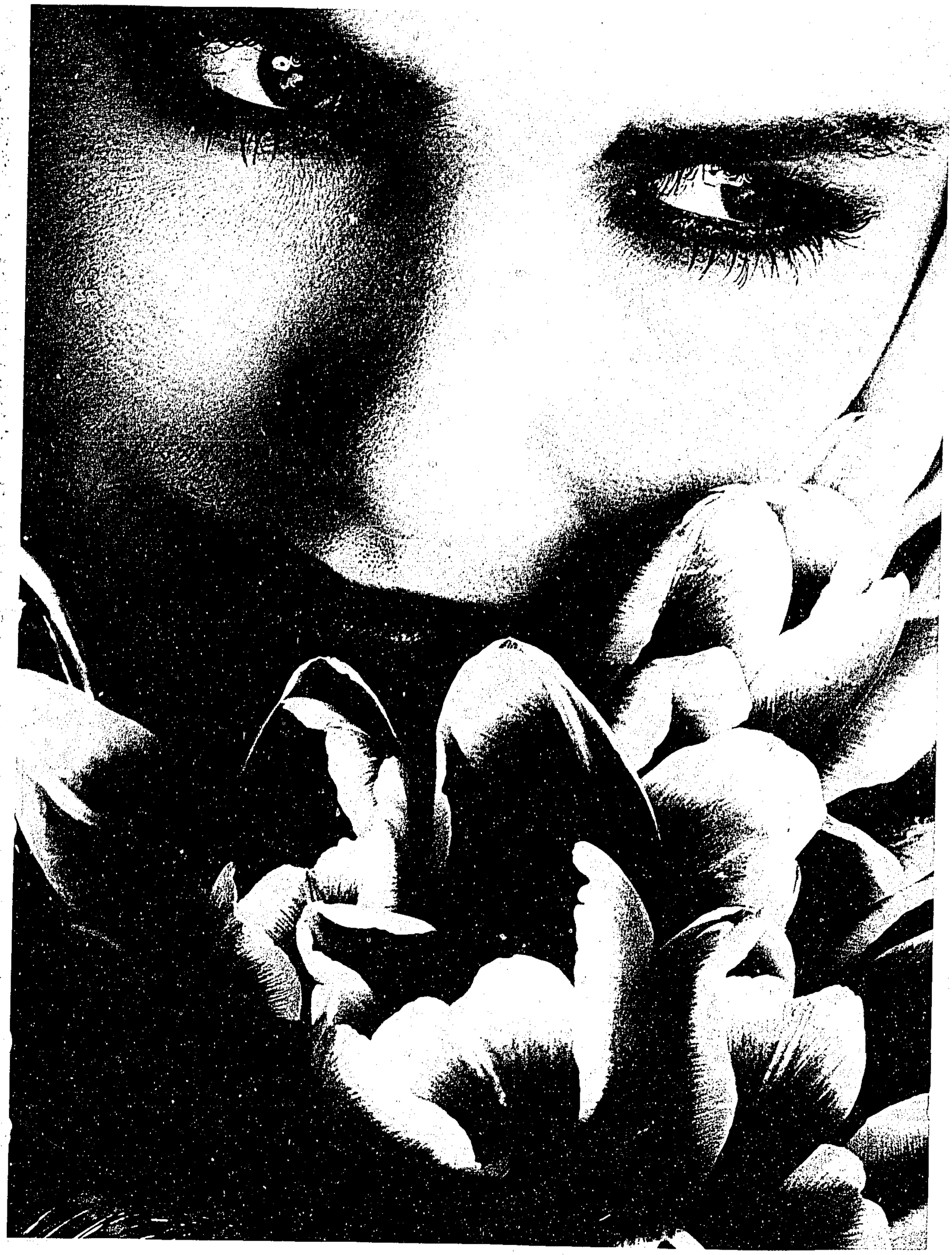
**STOCK EXCHANGE LISTINGS**
New York Stock Exchange
(Trading Symbol "LTD")
London Stock Exchange

**LEGAL COUNSEL**
Schwartz, Kelm, Warren & Rubenstein
Columbus

**INDEPENDENT PUBLIC ACCOUNTANTS**
Arthur Andersen & Co.
Chicago


THE LIMITED





# THE LIMITED

1985 ANNUAL REPORT

FILMED
MAR 1987
MIRAC